

**Japanese Real Estate Investment Trusts: Champagne Bubbles or Price Bubble?**

by

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B.A. Business Administration  
University of Oregon, 1996

SUBMITTED TO THE DEPARTMENT OF URBAN STUDIES AND PLANNING  
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF

MASTER OF SCIENCE IN REAL ESTATE DEVELOPMENT  
AT THE  
MASSACHUSETTS INSTITUTE OF TECHNOLOGY

SEPTEMBER, 2005

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Real Estate Development

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## ABSTRACT

In September 2001 the Japanese real estate industry marked a new era of real estate investments by issuing on the Tokyo Stock Exchange the first Japan Real Estate Investment Trust (JREIT). The initial JREIT performance was not so impressive. Now, as the Japanese economy continues to recover and more investors are looking to real estate securitization as a means of limiting balance sheet liability and increase real estate investment liquidity, the JREIT is becoming a popular investment vehicle. On the surface the public securitization of real estate seems a great opportunity for the average investor to participate in real estate investment while keeping liquidity.

What is the real story behind the JREIT: Are the assets in the JREIT overpriced? Is the race to issue new JREITs forming a price bubble in the Tokyo central business district? Is the JREIT a safe investment, or is it just a way for real estate firms to pass off the associated risks of overpriced real estate?

This paper will consider the status of the Japanese economy, the real estate industry, and the JREIT market from its beginnings to current levels.

Thesis Supervisor: David Geltner

Title: Chairman, Interdepartmental Degree Program in Real Estate Development

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## THE COUNTRY

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Japan is an island country located in the western Pacific Ocean. It comprises over 37 million hectares of area and is resident to approximately 126 million people. The country supports the world's second largest economy and its politics are democratic and stable. The citizens are highly educated, motivated and the nation generally keeps the unemployment rate below 5%.



<b>Area:</b>	approximately 37.78 million hectares
<b>Population:</b>	approximately 126 million
<b>Density:</b>	about 320 people per square kilometer
<b>Capital:</b>	Tokyo
<b>Main religions:</b>	Shintoism (39,5%), Buddhism (38.3%), Christianity (3.8%)
<b>Currency:</b>	Yen
<b>Economy:</b>	Highly industrialized
<b>Major natural resources:</b>	Fish, timber, fast flowing rivers
<b>Major products:</b>	Automobiles, electrical and electronic goods, textiles, steel, machines and robots
<b>Has four large islands:</b>	Hokkaido, Honshu, Shikoku and Kyushu, and about 3,000 much smaller islands around them. The islands run north to south for over 2500 kilometers.
<b>Land Related:</b>	Only 15 per cent of Japan is level enough for farming and building. Japan has 67 active volcanoes.
<b>Population Mix:</b>	99.2% of population is Japanese, 0.6% Korean and 0.2% Chinese and other nationalities.
<b>Urbanization:</b>	Japan has 11 cities of over 1 million people.

## THE CAPITAL - TOKYO

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Tokyo is not a city; it is a prefecture which stretches from mountain villages in the west to the islands 1000 km to the south, and encompasses more than two dozen cities. Tokyo is comprised of 23 special wards in the inner city area. They vary in size (from 10 to 60 km) and in population (from 40,000 to 830,000), although they resemble sizable cities in both respects.

The combined population of the 23 special wards is 8.28 million people, about two-thirds of the population of Tokyo and a quarter of the population of Greater Tokyo. The area has a population density of 13,333 per square kilometer (34,500 per sq mile). The central region has a total office stock of

approximately 82 million square meters of space, as of 1 January 2003, according to the latest update from the Tokyo Metropolitan Government.

## THE REAL ESTATE MARKET & ECONOMY

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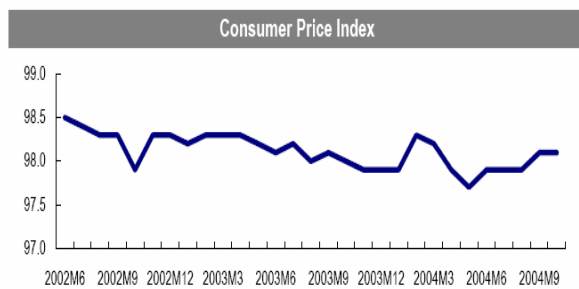
The following section was crafted to draw a picture of the current economic status of Japan with focus on several key economic indicators.

Since the end of WWII the Japanese economy enjoyed tremendous growth and revitalization of the nation which brought the country to the forefront in international economic prowess and the second largest economy in the world. Eventually, the growth got out of hand and resulted in what is known today as the Bubble Economy. With the increase in the price of Japanese exports, competitiveness was decreased overseas, while government financial measures increased demand domestically. Corporate investment rose sharply in 1988 and 1989. New equity issues rose in value as a result of higher stock prices, making them an important source of financing for corporations.

In the meantime, banks sought for funds in the outlet of real estate development. In turn, corporations used their real estate holding as collateral for stock market speculation. A direct result of this was the doubling of land value prices and a 180% rise in the Tokyo Nikkei stock market index.

In May 1989, the government tightened the monetary policies to suppress the rise in value of assets, including land. However, higher interest rates sent stock prices on a steady spiral down. The Tokyo stock market had fallen 38% by the end of 1990, thus effectively wiping out 2.07 trillion dollars in value. Steeply dropping land prices burdened financial institutions with bad debts and some of them even went bankrupt.<sup>1</sup>

While economic stabilization from the Bubble Economy has taken all of the past decade to be realized there is a long way to go before returning to the levels in the late 1980s. However, the Bank of Japan gave its most upbeat assessment of the economy since the bubble burst in 1990. The economy grew 1.5% in Q1 2004 from the previous three months or an annualized 6.1%. The unemployment rate for May fell to 4.6%, the lowest level since August 2000. The figure continued the improvement from the country's worst jobless rate of 5.5% seen in January 2003 and August 2002.



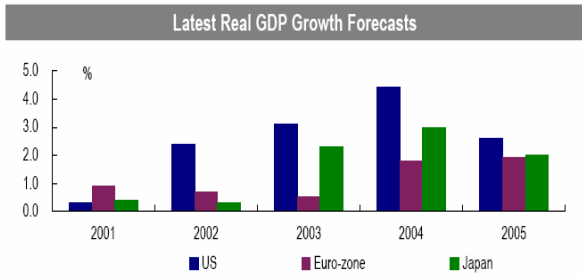
Source: Ministry of Public Management, Home Affairs, Posts and Telecommunications

SOURCE: Jones Lang LaSalle. "Tokyo Property Market Monitor." JLL. May 24, 2005.

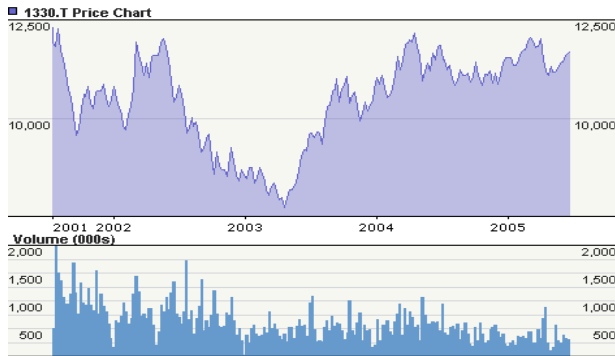
Although the economy has incurred some deflationary tendencies in recent years the overall CPI has remained relatively stable and fluctuated between a narrow range of 98 to 98.5. It is estimated that no significant changes will cause recognizable increases in volatility.

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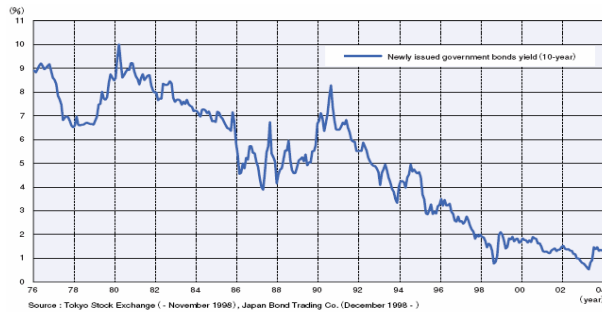
<sup>1</sup> [www.asianinfo.org](http://www.asianinfo.org)



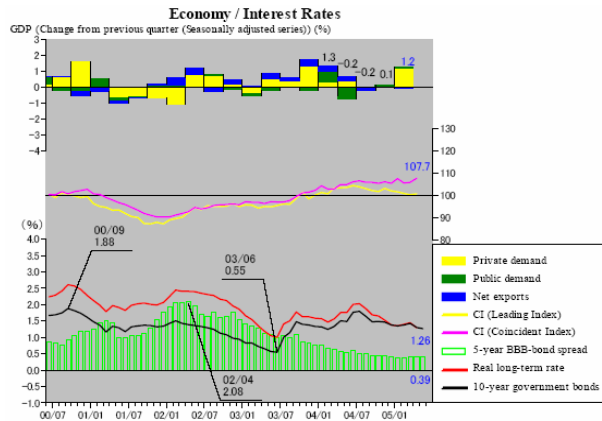
Source: EIU 2004



The Nikkei Index Stock Movement (2001-2005)



The 10-year JGB Yields (1976-2004).



Economy / Interest Rates

SOURCE: Jones Lang LaSalle. "Tokyo Property Market Monitor." JLL. May 24, 2005.

As a country of the second largest economy in the world, the latest GDP growth estimates place Japan in a close race with the US and European countries. This demonstrates a strong stable investment grade market.

SOURCE: investing.reuters.co.uk

The Nikkei Index is the primary stock market portfolio in Japan. It represents a listing of 225 major stocks in the market and is the world's second largest trading market behind the NYSE. The Nikkei has been in a slump since the recession began and has fluctuated around a relatively stable range of 8500 to 12000. Since the bubble investors have been very cautious about reinvesting back in to the market.

SOURCE: The Ministry of Finance of Japan. "Guide to Japanese Government Bonds 2004." Ministry of Finance. 2004.

The JGBs are at a 10 year low, down from nearly 10% in 1980 and continually decreased since 1991. In FY2004, the total issue amount of JGBs is to be around 162 trillion JPY. This amount is a huge increase since the early 90s and was relatively stable at around 30-40T JPY since 1998.

SOURCE: Cabinet Office, Bank of Japan

In Q1 2005 the real GDP showed a gain of 1.2% from the previous quarter, which projects a 2005 annualized rate of 4.9%.

Long-term interest rates averaged 1.26% in May 2005, down slightly from the previous month. The five-year BBB bond spread was .39%, the lowest level in over five years.

## OTHER ECONOMIC ISSUES

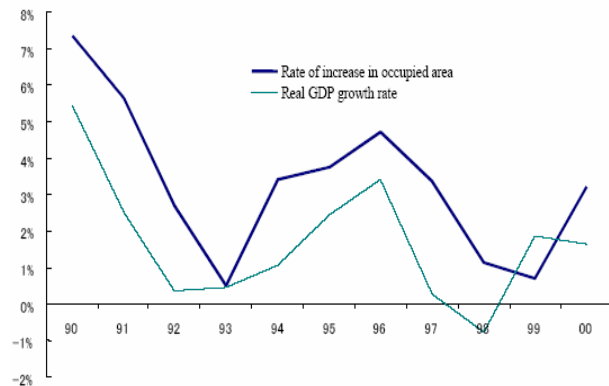
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In the near future several large scale economic related changes will take place in Japan which may have a major negative affect on the economy, and as a result real estate market. Known sometimes as the “2007 Problem” (the first step toward the “2010 problem”) the events include **1)** the estimated start of a total population decline (estimated at 0.5% per year through 2050), **2)** a massive retirement of baby-boomers (resulting in a generational transfer of wealth which will likely lower the savings rate), **3)** postal privatization (Prime Minister Koizumi’s main goal; still vague and unknown if it will be successfully completed. If implemented, will cause an affect on the demands from postal services on the financial services and may then cause strains on the regional banking industry), **4)** a large amount of long-term Government Bonds (JGBs) will mature (which will require a large sum of new government bond issuances; affecting postal savings, insurance and pensions), and **5)** a large influx of new office supply in Tokyo (estimated at 1.35MM square meters of new space. While very large is it only 62% of the ‘2003 Problem’ of new stock, which was quickly absorbed by the market).

Positive changes include the **A)** end of bans on financial institutions working as securities intermediaries, **B)** the lifting of government guarantees on bank deposits, and **C)** the netting of financial income for taxation purposes; which will likely cause a gradual shift in personal financial assets from deposits to riskier asset classes, like equities and equity investment trusts and securitized real estate.

Moreover, the foreign investor-led market has continued, but this may end in the future and domestic investors will return in force as the dominant force in the market.<sup>2</sup> According to The Wall Street Journal (Thursday, June 30, 2005. Foreign Investment in Japan Hits a Record), foreign companies’ investments into Japan rose to 4.03 trillion JPY (36.67B USD) in the past fiscal year; almost double the average for the past three years since 2001. The data showed that foreign finance and insurance companies boosted their investment to 2.98 trillion JPY from 1.02 trillion JPY.

The following section will help to further elaborate on the projected mass-retirement of workers and its overall expected impact on the real estate market.

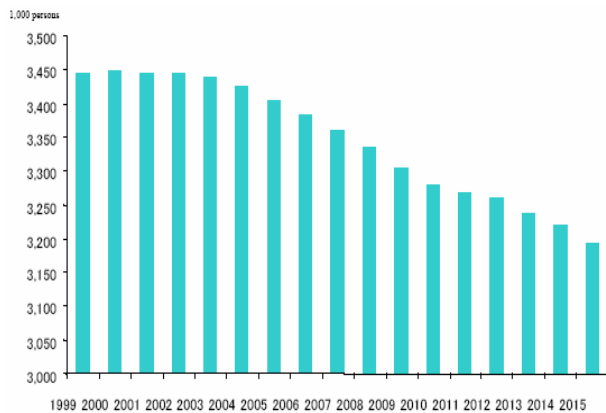


Office Demand and Economic Growth.

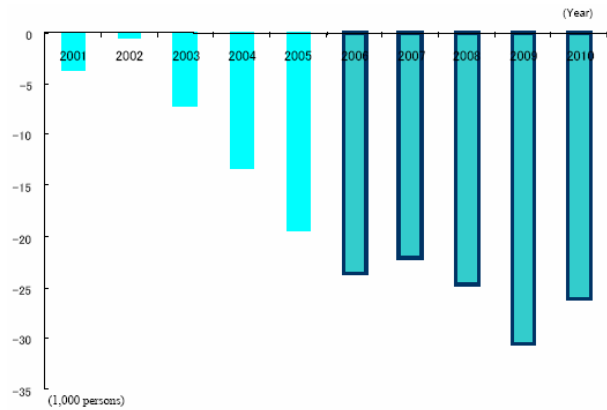
SOURCE: Merrill Lynch. “What Really Happens in 2007.” Tokyo Research. October 18, 2004

Historically office demand and economic growth have demonstrated a high correlation, and as a result without a strong economic recovery the office demand will continue in kind. While economic growth is making an effort to comeback, it is still sluggish and the outlook is uncertain.





Predicted Number of Office Workers (Tokyo 23ku)



Annual Decrease in Office Workers (Tokyo 23ku)

SOURCE: NLI Research Institute. “Tokyo Office Market’s “2010 Problem.” Attractors Lab Co., Ltd. 2002

SOURCE: NLI Research Institute. “Tokyo Office Market’s “2010 Problem.” Attractors Lab Co., Ltd. 2002

This projected future decrease in office demand is a potential problem for real estate professionals. It is projected that the number of office workers will decrease 5% by 2010, which is equated to approximately 3.7MM square meters (37MM square feet) of office demand. In fact, this issue is such a concern, that the government is considering extending the mandatory retirement age of workers from 60 to 65. While the immediate impact of this drop in employees will not be seen for many years (due to lease renewal periods, time for office consolidation, and general lag-time), it is an issue that real estate managers and investors are faced with and must formulate appropriate long-term strategies in order to limit the potential negative results. Acquiring class-A buildings in great locations, developing a strong tenant mix, focusing on tenant services, and repositioning weaker assets will become more important as the market changes.

## BUSINESS STRUCTURE

After WWII, following the American occupation authorities' attempted to dissolve the powerful family-owned conglomerates; then known as the Zaibatsu. The Zaibatsu dissolution was not implemented effectively and resulted in a metamorphosis of business structure in order for corporations to survive. As a motivation to survive, companies within the former Zaibatsu joined together through a system of cross-ownership and shareholding, whereby each company owned shares in all other group members. Within this structure, the major shareholders tended to be a bank, a general trading company, and a life insurance company – these structures became known as the Keiretsu.

The modern Keiretsu is a group of companies with interlocking business relationships and shareholdings; the horizontal and vertically linked structure of Japanese multi-national companies. The horizontally linked groups include various industries linked by majority shareholdings in banks and trading companies. The vertically structured groups are built around parent companies with subsidiaries serving as support for the parent in supplying and distributing materials. A key component or feature of the groups are crossholding of stocks, intra-group financing, joint investment, mutual appointment of officers, and other joint business.<sup>3</sup> Historically, real estate was seldom auctioned for sale, and when it was the sales were usually between two firms within the same keiretsu family; thereby limiting opportunities for third party investors. Much of the prime real estate is owned by these conglomerates and is a symbol of power and

<sup>3</sup> [www.wikipedia.org](http://www.wikipedia.org). search on “Keiretsu”

the status of such organizations. Because of this unique structure there has been a historic challenge for foreign and private individual ownership of real estate.

Because listed companies bought and held onto shares in other listed companies, the ratio of shares owned by individuals in Japan has steadily declined to around 20% by 2003. This has made management rather complacent and greatly reduced shareholder rights. The culture of Japan is slow to change. The attitudes and social perceptions from long associations are entrenched. However, an unprecedented change in the attitude and investment strategy of Japanese real estate owners is taking hold in the industry and institutional owners are becoming more willing to liquidate real estate to avoid further economic distress. Real estate is still prized in Japan, but until recently the owners of real estate were limited to non-foreigners and generally controlled by Keiretsu who considered real estate trophies within the firms. After the economic crisis and collapse of the real estate bubble real estate prices have continued to fall and forced many owners to consider the unthinkable, to sell off assets. A trading market has developed and grown over the last several years. Now that trades are accelerating they are providing more opportunities for buyers; according to The Wall Street Journal (Wednesday, June 29, 2005. Land of Rising Property Prices), referring to the possible sale of 2B USD of Seibu Railway Co.'s hotels assets, "In many other markets, deals like this would be business as usual. But in Japan, where real-estate prices have plummeted for more than a decade, and nobody wanted to sell property unless absolutely necessary, most deals have been for property pledged as collateral for bad loans. The potential sale of the Seibu properties – a high-profile deal that isn't related to bad loans – is one of the most prominent signs the market could be turning around."

## CENTRAL TOKYO OFFICE MARKET

While there are many different mini-CBDs in Tokyo, the primary CBD comprises Chiyoda-ku, Minato-ku and Chuo-ku, which together account for about 40 million sqm (430 million sqf) or half of the office stock (GFA) in the 23-kus. Other important commercial areas outside Tokyo include the satellite cities of Kawasaki, Yokohama and Chiba.



The Central 5 wards have the highest concentration of office buildings.

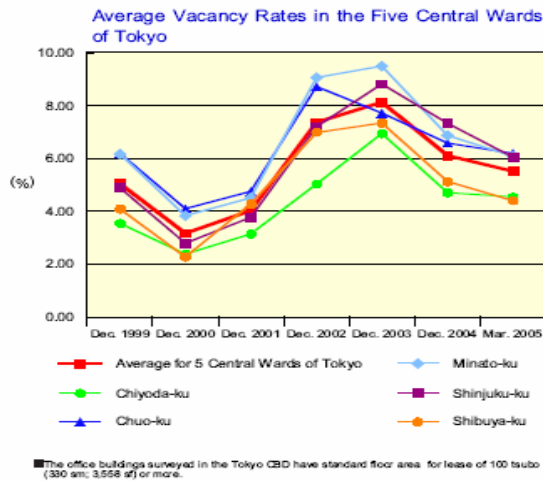
**Chiyoda-ku** – Home of the financial districts of Marunouchi and Otemachi, where many Japanese corporate HQs are located.

**Chuo-ku** – Includes Tokyo Station and the Tokyo Stock Exchange and the Bank of Japan.

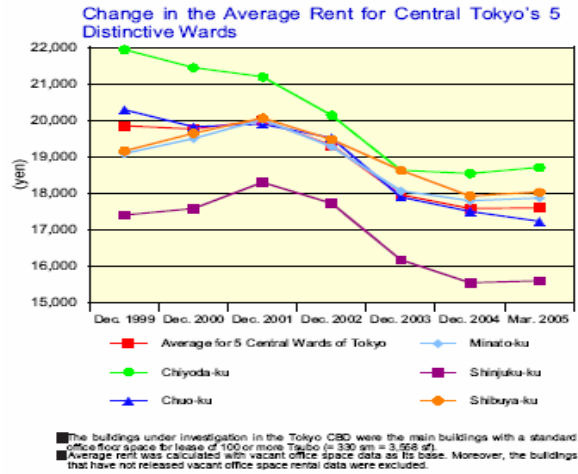
**Minato-ku** - Good supply of quality office assets located close to prime residential areas and is popular with many foreign companies and financial institutions.

**Shinjuku-ku** – An important center for large Japanese and foreign corporations; mostly west of Shinjuku Station, which is the largest rail terminal in Japan.

**Shibuya-ku** – The center for young culture, fashion, design and entertainment, and has become popular among technology and ecommerce companies.



SOURCE: Miki Shoji Co., Ltd. "Tokyo (5 Central Wards) Office Building Market Research Report." April, 2005



SOURCE: Miki Shoji Co., Ltd. "Tokyo (5 Central Wards) Office Building Market Research Report." April, 2005

Table 1: Office Stock by Location

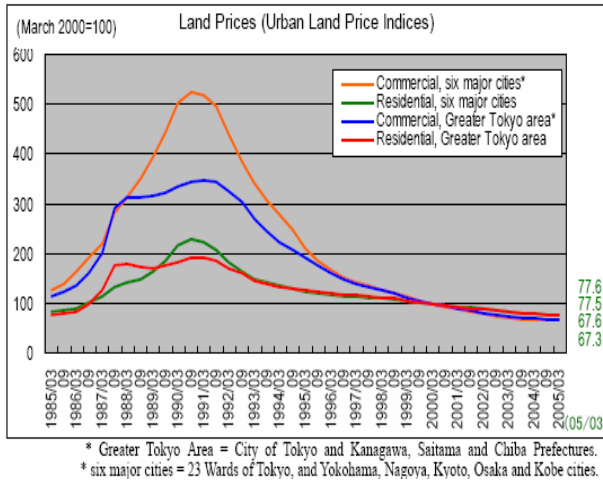
Sub-locations	Total NLA (sq.m)	Grade A Stock as % of Total NLA	Major Office Buildings
CBD			
- Chiyoda-ku	- 5,158,247	- 19.9%	Marunouchi Building, Sanno Park Tower
- Chuo-ku	- 969,079	- 0.0%	Nihonbashi 1-chome Bldg., St.Lukes Tower
- Minato-ku	- 5,688,219	- 45.0%	Roppongi Hills Mori Tower, Shiodome City Center
Shinjuku-ku	7,773,561	66.6%	Shinjuku Oak Tower, Shinjuku I-Land Tower
Shibuya-ku	3,054,906	10.3%	Yebisu Garden Place, Shibuya Mark City
Shinagawa-ku	556,874	49.8%	Gatecity Osaki, Tennozu Central Tower
<b>TOTAL</b>	<b>23,200,886</b>	<b>19.0%</b>	

SOURCE: Jones Lang LaSalle. "Corporate Occupiers Guide (Asia Pacific)." JLL. August, 2004.

Reflecting the growing optimism in the economy, demand for office space was strong in 2004. The class-A vacancy rate fell for the fourth consecutive quarter to 5.1%. The CBD 3-kus have benefited from corporate upgrading and expansion activities. The peripheral districts of Shibuya, Shinjuku and Shinagawa have also seen more leasing activity as a result of growth in the domestic economy.

The primary investment target area is Tokyo's primary six wards, which contain 23MM sq meters of office stock, with another 190,000 sqm of new office space currently under construction and scheduled to be completed within the next six months, of which more than 70% is pre-committed suggesting strong absorption by the market.

Only 20% of the entire stock is categorized as class A, which means a large pool of stock exists for B and C class assets from which some should be available at a discount. However, the trends suggest that through the intense competition for class-A buildings it is becoming more difficult to acquire such assets. As a result, the B and C class stock and those markets outside the central CBDs are becoming more expensive with inflated prices; a potential dangerous outlook.

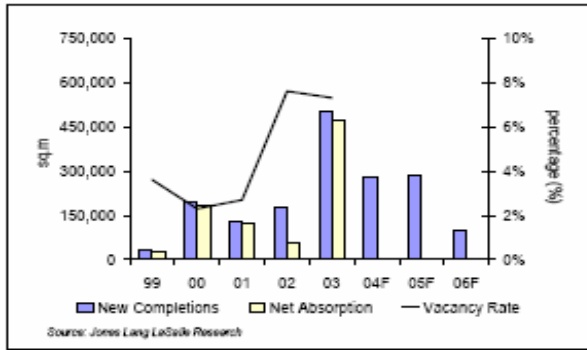


SOURCE: Mitsui Fudosan. "Statistical Chart." Real Estate Investment Research Institute. June 2005.

Land prices were notoriously over priced until peaking in the early 90s, before coming to a crashing fall over the past decade. In some areas real estate has dropped over 50% and continues to fall, but at a lower rate than in previous periods.

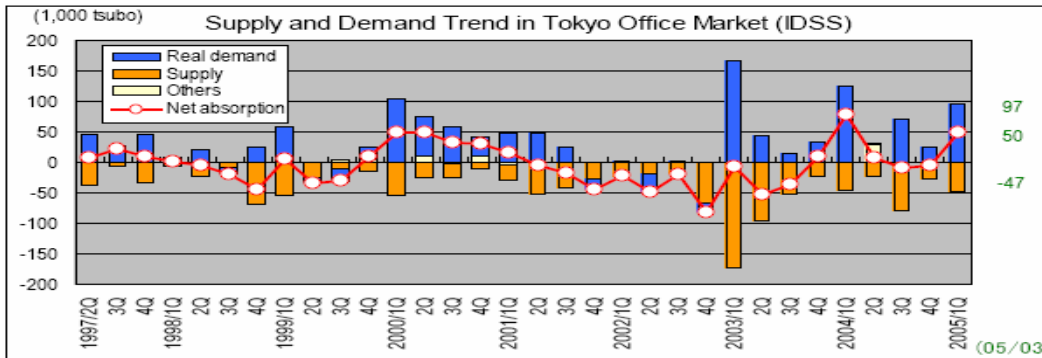
However, in some major cities it is believed that commercial land prices may have bottomed out and in some instances posting gains of 0.2% since the last period.

Office Demand, Supply and Vacancy - CBD



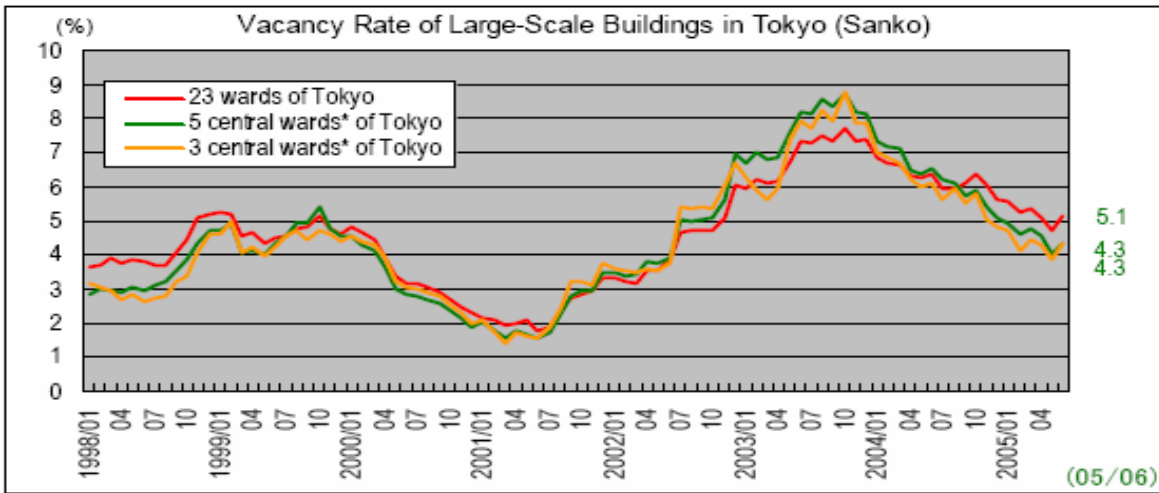
SOURCE: Jones Lang LaSalle. "Corporate Occupiers Guide (Asia Pacific)." JLL. August, 2004.

The supply and vacancy forecasts for the coming years also suggest upward pressure on rents, as the new supply projects are on the decline. Depending upon the absorption rate, may provide real estate owners with stronger leverage in leasing and stabilizing the projected income in assets.



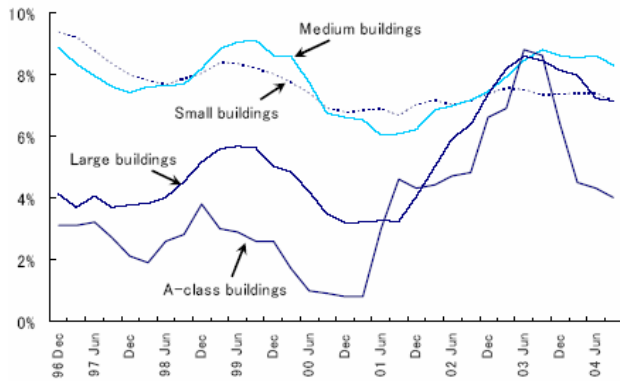
SOURCE: Ikoma Data Service System (IDSS)

New supply has always been a potential source of downward pressure on the real estate market, however the Tokyo area has shown a strong ability to absorb new supply with little or limited short-term impacts. Considering the current vacancy and rent trends in the core business areas, new supply is not estimated to negatively affect the overall real estate values and investment opportunities suggests strong long-term value sustaining indicators. In Q1 2005 supply reached 47,000 tsubo (1.67MM square feet) and demand was reported to be 97,000 tsubo (3.45MM square feet), leaving a net difference of 50,000 tsubo (1.78MM square feet); which is a strong reason for the improved vacancy rates in the market. Over the next couple of years new supply is projected to be somewhat limited and may be a source of upward pressure on the market performance. 1 tsubo = 3.308575 square meters = 35.6 square feet.



SOURCE: Sank Estate Co., Ltd

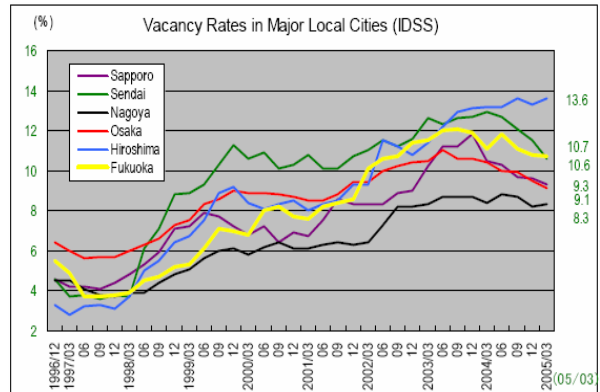
Vacancy rates in Tokyo rose dramatically during 2003 with the onslaught of new supply (approximately 2.1MM square meters). The market absorbed much of the new supply and has fallen between 4-5% in 2004. However, in June 2005 the vacancy for the 23-ward area worsened by 0.40 points to 5.11%.



Vacancy Rate in Central Tokyo by Building Size.

SOURCE: NLI Research. “Tokyo Office Market Trends – Cloudy Outlook for Leasing, While Investment Heats Up.” Financial Research Group. January 2005

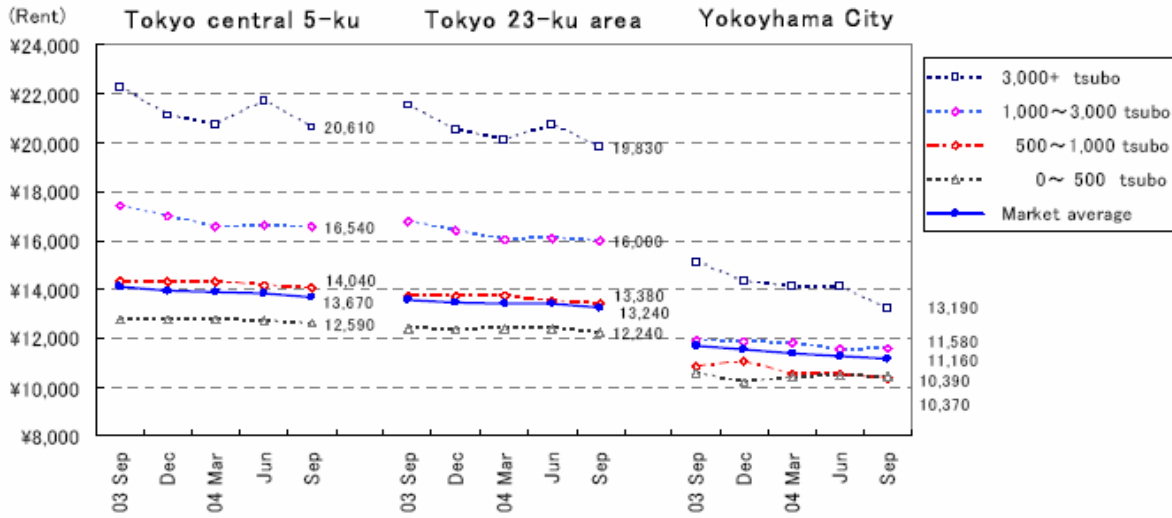
The 2003 problem (a flood of new supply that hit the market in 2003) caused a temporary spike in the vacancy rates with the influx of new supply to the market. The majority of new supply from the 2003 problem was class-A office space, which has since made a strong recovery. However, it has been at the cost of the smaller buildings and larger class buildings outside of the Tokyo CBD which are suffering from the migration of business back to central Tokyo.



SOURCE: Ikoma Data Service System (IDSS)

While Tokyo’s vacancy rates are between 4-5% the real estate markets in other major cities within Japan are much weaker.

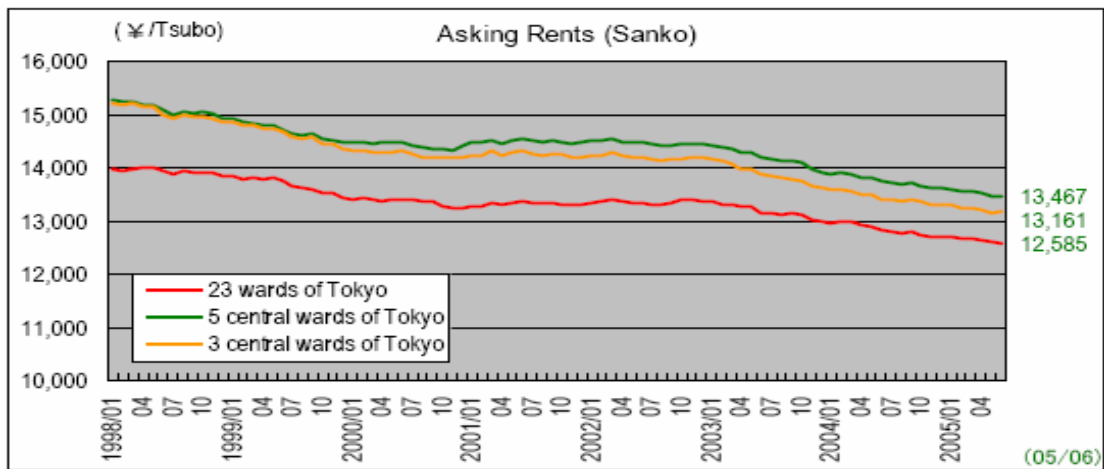
2004 has shown improvements in all of the areas, but the outlook going forward is still uncertain, with worsening already apparent in Hiroshima and Nagoya.



Tokyo Office Rent by Area and Building Size (monthly rent per tsubo)

SOURCE: NLI Research. “Tokyo Office Market Trends – Cloudy Outlook for Leasing, While Investment Heats Up.” Financial Research Group. January 2005.

The Tokyo market has been relatively stable, but at the cost of surrounding areas such as Yokohama and Chiba, which are bearing the weight of the market duress. It is clear that the most stable and highest cash flow generating real estate is large scale buildings in the Tokyo central five prefectures. However, these represent only 19% of the stock in the Tokyo CBD, which suggests that 81% of the market is exposed.



SOURCE: Sanko Estate Co., Ltd. (per month)

Office rents have been on the decline for 10-years, since the economic bubble’s collapse in 1993. While some of the larger Class A buildings have bottomed out and are showing some signs of trending upward, the overall average in the market continues to decline. As of June 2005 the 23-ward area declined by 0.2% from the previous month and 1.8% from the previous year.

1 tsubo = 3.308575 square meters = 35.6 square feet.

1USD = 110JPY (as of July 12, 2005)

## MARKET PARTICIPANT OUTLOOK

According to an estimate by Nikkei Real Estate Market Information, in the last two years (2003-2004), JREITs have accounted for approximately 50% of ALL office property transactions with cap rates below 5%; 10 of 22 in 2003, and 16 of 26 in 2004. The lowest was 3.3% for a 14.4B JPY acquisition of the Urban Development Corporation HQ building by Tokyo University of Science (Non-JREIT).

Property type	Location	2001	2002	2003	2004	Average 2001-04
Office	Central Tokyo	6.4%	6.4%	6.1%	5.8%	5.9%
	Rest of Tokyo area		7.7%	7.7%	6.1%	6.5%
	Other areas		7.2%	6.7%	7.2%	7.0%
	Average	6.4%	6.8%	6.6%	6.1%	6.3%
Residential	Central Tokyo			5.8%	5.3%	5.5%
	Rest of Tokyo area			6.9%	5.8%	5.9%
	Other areas			6.5%	6.7%	6.6%
	Average			6.0%	5.7%	5.8%
Commercial	Average			6.1%	5.5%	5.7%
All types	Central Tokyo	6.4%	6.4%	5.8%	5.5%	5.7%
	Rest of Tokyo area		7.7%	7.3%	5.9%	6.1%
	Other areas		7.2%	6.6%	6.9%	6.8%
	Average	6.4%	6.8%	6.3%	5.9%	6.0%

Notes: Central Tokyo consists of Chiyoda-ku, Chuo-ku, Minato-ku, Shinjuku-ku and Shibuya-ku. Rest of Tokyo area excludes central Tokyo, but includes Chiba-ken, Saitama-ken and Kanagawa-ken. Other areas refers to the rest of Japan, primarily Osaka, Nagoya, and Fukuoka.

Source: J-REIT disclosures

### Appraised NOI Cap Rate at Time of Purchase

SOURCE: NLI Research. "Trends in the Return on Real Estate Investment of J-REITs." Financial Research Department. April 2005.

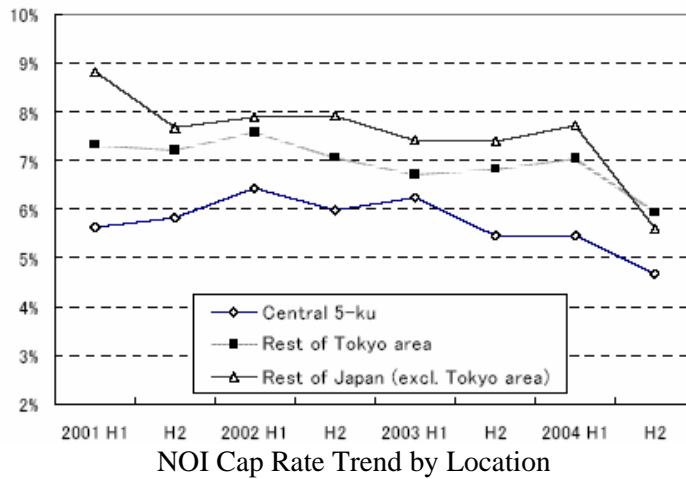
As an analysis of the JREITs and the price appreciation occurring in the real estate market the NLI Research group examined the returns (cap rates) that JREITs expected when they invested in their assets, based on the public information and appraisals acquired at the time of purchase. The above graph shows the projected yields of the assets, based on projected NOI. From this we can see that the overall average yield has dropped from 6.8% to 5.9%, from 2002 to 2004. A key area to note is the major drop in office product in the 'Rest of Tokyo,' or secondary market areas. This is due to the tough competition and limited class-A real estate available in the market. The non-central and lower quality real estate assets are much more vulnerable to corrections in the market.

Area	Total	Office	Residential	Commercial
Central 3-ku	5.4%	5.5%	4.9%	6.2%
Subcentral 2-ku	5.3%	5.6%	4.9%	
23-ku	6.5%	6.7%	6.0%	
Tokyo area	6.6%			
Kansai area	7.1%	7.0%	7.3%	
Chukyo area	7.9%			
Fukuoka area	7.1%			
Average	6.1%	6.1%	5.9%	6.2%

SOURCE: NLI Research. "Trends in the Return on Real Estate Investment of J-REITs." Financial Research Department. April 2005.

NOI Cap Rate of JREIT Properties Purchased in 2004. JREITs dominated the low yielding investments, with transactions such as,

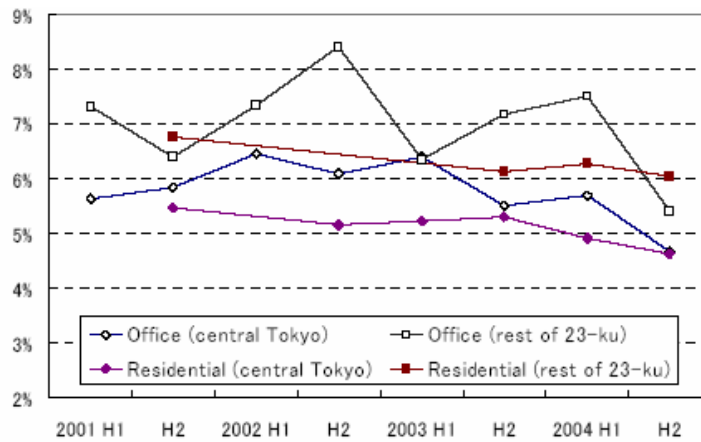
- Nomura Real Estate Office Fund; acquired the JAL Building at a 3.8% cap.
- Mori Trust REIT; acquired the Mita MT Building at a 4.1% cap.
- Japan Real Estate; acquired the Ebisu Neonade at a 4.2% cap.
- Global One; acquired Ginza First Building at a 4.2% cap.
- Japan Real Estate; acquired the Higashi Gotanda Ichome Building at a 4.3% cap.



SOURCE: NLI Research. "Trends in the Return on Real Estate Investment of J-REITs." Financial Research Department. April 2005.

Within the past five years cap rates have dropped from a range of 5.5% to 9% for class-A office buildings, to a range from 4% to 6% (the spread from 350 to 200 basis points). While some cap rate compression is normal in a growing healthy economy, a point to be concerned about is the steep drop in the last year and the halving of the spread between the Central 5ku and areas considered less ideal for investment.

Does the traditional spread no longer accurately reflect the different risks associated with non-central Tokyo areas?

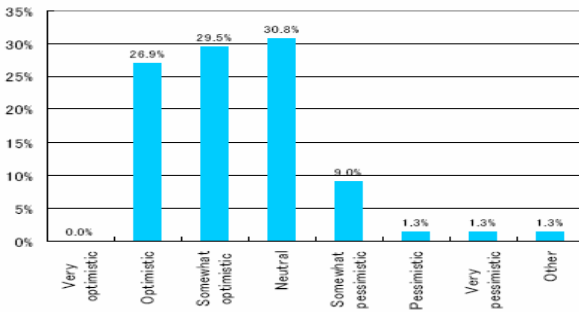


NOI Cap Rate Trend by Property Type in the Tokyo Area.

SOURCE: NLI Research. "Trends in the Return on Real Estate Investment of J-REITs." Financial Research Department. April 2005.

While the downward sloping trends of cap rates are not of a surprise in the recovering economy, the volatility of the office cap rates (non-central 5ku) and as mentioned above the closing of the gap between different regions should be cause for concern.

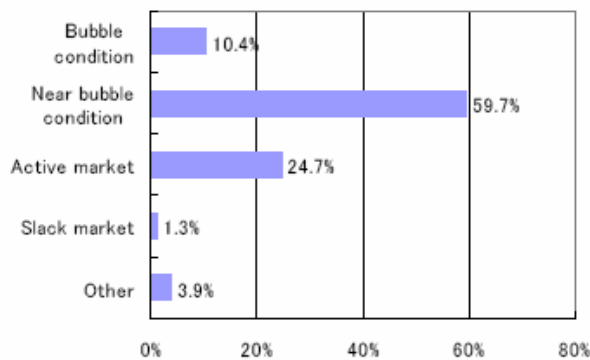




Outlook for the Tokyo Office Leasing Market (Upcoming Year Forecast)

SOURCE: NLI Research. “Tokyo Office Market Trends – Cloudy Outlook for Leasing, While Investment Heats Up.” Financial Research Group. January 2005.

According to the results of the office market outlook survey 87.2% of the respondents are either neutral or optimistic on the coming year’s leasing rents and absorption expectations.



Outlook for the Tokyo Office Market Activity

SOURCE: NLI Research. “Tokyo Office Market Trends – Cloudy Outlook for Leasing, While Investment Heats Up.” Financial Research Group. January 2005.

Interestingly enough, 70% of the same questionnaire respondents believe the market is overheated and in a near bubble condition. Bubble and Near Bubble Conditions were differentiated only by the number of transactions in the market that were considered “transactions with prices that defy understanding.”

## THE MARKET – CONCLUSION

Land prices are still on a decline and very little suggests that land will rebound anytime soon.

Vacancy rates are strong for Class-A buildings and have been up to 800 basis points lower than large, medium, and small size buildings in Tokyo. Now at around 4-5% they are still 50% below lower class real estate products.

Rental rates are still on the decline, with a 30-40% swing in average rental rates among large, medium, and small assets. Some may argue that the rental rates should begin to recover; however, such improvements will be limited to pockets of areas, while the rest of the market will continue to decline.

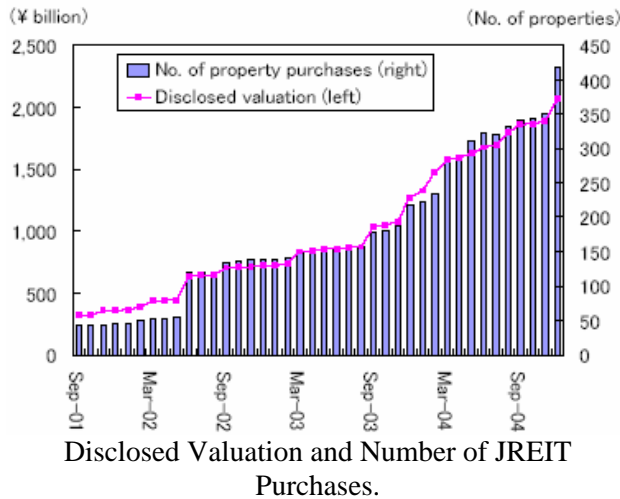
Supply will be rather conservative over the next few years and demand will continue to be under downward pressure through the year 2015 with the projected decrease in worker numbers. Without major economic growth to offset this trend, real estate owners and operators will have to adjust their long-term strategies to mitigate negative affects.

Meanwhile, cap rates continue to drop as the number of investors climb. Many investors however, are concerned about the declining trends in cap rates, which seem to be dropping without any regard to individual assets or property risks; generating low returns for non-superior properties in secondary markets.

The market in Japan can best be described as soft on leasing and red hot on the investment side. Whether this is a “bubble” or just a small rise in the bigger cycle of the real estate market is unclear.

## EXPLORING THE JREIT

The Japanese Real Estate Investment Trust market was initiated in September 2001 with the first two listed JREITs. The first two years were relatively slow going for the REIT market. The 9/11 attacks in New York and Washington probably had some effects, but most investors were taking a wait and see attitude toward the market and using the time to organize partnerships and structure the appropriate entities for future listing. In 2003, with a flood of announcements the market activity began to explode.

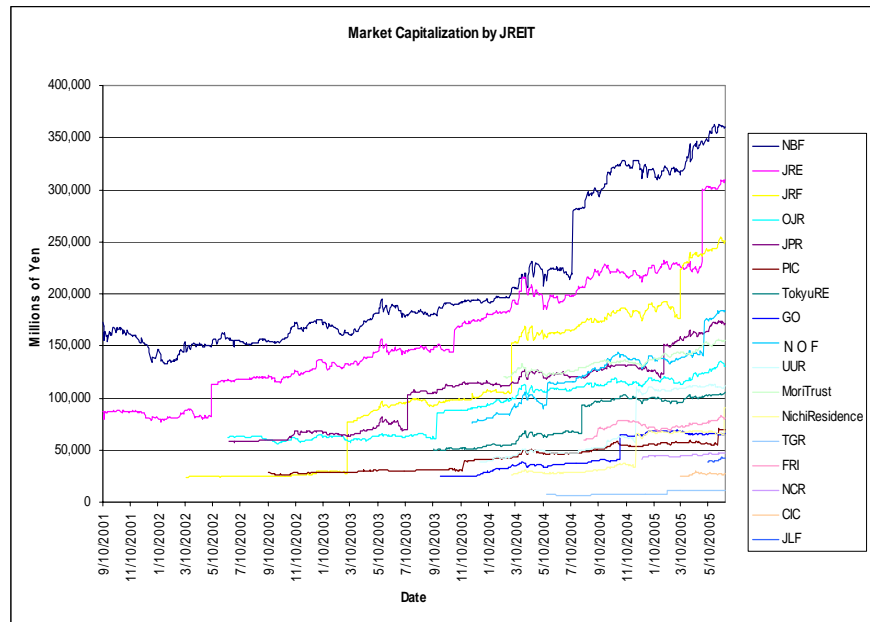


SOURCE: NLI Research. "Trends in the Return on Real Estate Investment of J-REITs." Financial Research Department. April 2005.

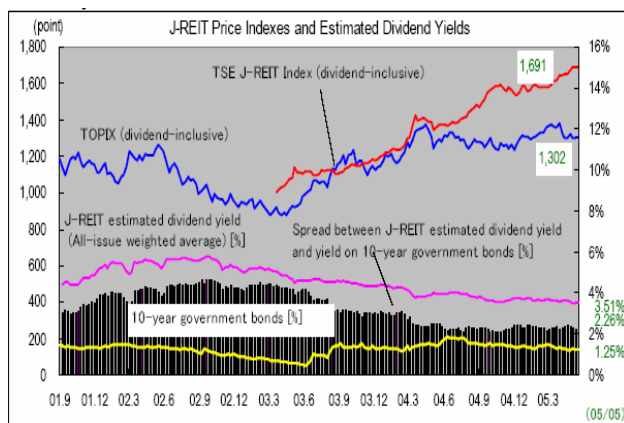
Property purchases by JREITs have grown fast. By 2004 year end the number of properties acquired for injection into and by JREITs rose 9.5 times from 44 to 418. So long as the demand for real estate securitization and the listed JREITs have not met their specified investment levels, the growth should continue at an aggressive rate for at least the near term; adding further downward pressure on cap rates.

2,500B JPY is approximately 25B USD.

Name	MM JPY	wtd
NBF	360,324	16.3%
JRE	308,788	14.0%
JRF	251,272	11.4%
OJR	130,828	5.9%
JPR	171,190	7.7%
PIC	69,966	3.2%
TokyuRE	105,080	4.7%
GO	65,246	2.9%
NOF	183,516	8.3%
UUR	112,050	5.1%
MoriTrust	155,360	7.0%
NichiResi	90,707	4.1%
TGR	11,588	0.5%
FRI	81,144	3.7%
NCR	47,641	2.2%
CIC	26,905	1.2%
JLF	41,769	1.9%
<b>Total</b>	<b>2,213,373</b>	<b>100%</b>



Market Capitalization grew from 260MM JPY with the first two JREITs to the now (as of 6/17/2005) estimated 2,213MM JPY, an increase of 751% over the past four years. In addition to the current listed JREITs, another four are expected to be listed in July 2005 (see expected new JREIT section), and many more in the pipeline.



SOURCE: Tokyo Stock Exchange

JREITs have outperformed the TOPIX, based on three major factors. 1) Anticipated economic recovery (whether real or not), 2) Higher investor recognition through increased transparency in the market, 3) Improved liquidity through securitization. The overall dividend for the JREIT index at the end of May was 3.51%, giving a spread over the long-term interest rates of 226 basis points.

## STRUCTURE OF THE JREIT<sup>4</sup>

The JREIT is the abridged name for Japanese Real Estate Investment Trusts. As in the US a REIT is an investment trust with underlying real estate assets that generate income from the rents collected from those properties. Investors receive certificates which are traded on public exchanges, such as the Tokyo Stock Exchange (TSE), in the same way corporate stocks are.

There are two types of JREITs, contract-type (Investment Trust) or corporate-type (Investment Corporation). These are further divided into open-end REITs and closed-end REITs, depending whether the investor capital is redeemable.

**Corporate Style JREIT:** There are three primary characteristics of this type of REIT and that is, a special corporation is formed for the sole purpose of investing money into and managing real estate, this special corporation uses investor money to acquire real estate, and the investors receive stock certificates, which are traded on the public exchange. The corporation is considered responsible for the ownership and operations of managing the real estate; in general these responsibilities are contracted to a third party real estate management or operating company.

**Contract Style (Intermediated and Direct):** The primary difference in these types of investment trust is that in the Intermediated Contract the JREITs are operated by fund managers and administrators who are responsible for selecting the assets the investment bank will own and manage. The investment trusts undertake the direct management function. Under a Direct Contract style the investment banks owns and manages the underlying real estate assets. That is, the difference is whether or not a fund manager is acting as an intermediary between the bank which manages the fund assets.

The differences can be summarized by the following table.

	Contract Style		Corporate Style
	Intermediated	Direct	
<b>Asset Holder</b>	Investment Bank		Corporation
<b>Asset Manager</b>	Fund Manager	Investment Bank	Fund Manager
<b>Certificate</b>	Beneficiary Certificate		Investment Certificate
<b>Issue of Bonds</b>	No		Corporate Bonds
<b>Loan</b>	by Investment Bank		by Corporation

<sup>4</sup> [www.tse.or.jp](http://www.tse.or.jp)

## **CHARACTERISTICS OF REITs**

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As in the US a JREIT is a company that buys, manages, and sells real estate assets. The JREITs allow participants to invest in a professionally-managed portfolio of real estate properties. Properties may include apartment buildings, office buildings, shopping malls, hotels, or other commercial space where income is being generated. The JREIT also qualifies as pass-through entities and must distribute at least 90% of its profits annually and are paid out as dividends to shareholders. The JREIT can deduct these dividends from its taxable income. The JREIT can not pass along any tax losses to the investors and the investors pay capital gains tax on dividends received.

The average REIT is considered to offer the following benefits to the market and investors – low volatility, consistent and steady profits, strong dividends, convenient liquidity, low correlation with other asset classes and professional management

## **CRITERIA FOR LISTING A JREIT<sup>5</sup>**

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The listing criteria for the TSE is based primarily on the nature and proportion of real estate assets owned and held within the fund, as detailed below,

### **Assets under Management**

- Real estate must make up at least 75% of total assets under management.
- Assets must be real estate related, cash or highly-liquid cash equivalents.
- At least 50% of total assets must be income producing, and not likely to be sold within a year.
- The investment trust management company must be certified to make discretionary transactions under housing construction law.

### **Fund**

- Real estate must make up at least 75% of total assets under management.
- Total assets of at least 5B JPY (approximately 50MM USD).
- Net assets per unit of at least 50,000 JPY (approximately 500 USD).
- Borrowings must be raised from an eligible institutional investor.

### **Distribution**

- At least 4,000 units listed.
- At least 1,000 unit/shareholders/investors.
- Major unit/shareholders may hold no more than 75% of listed units.

## **JREIT DISCLOSURE REQUIREMENTS<sup>6</sup>**

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The disclosure requirements for the JREIT is similar to the requirements of corporate stocks; primarily focused on the investment corporation, assets under management, and financial performance.

**Investment Corporation:** Required to report on topics related to the new unit (certificate) issues and sales, including unit splits. In addition, orders to change or improve operations, and information related to the fund management contractors must be reported.

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<sup>5</sup> [www.tse.or.jp](http://www.tse.or.jp)

<sup>6</sup> [www.tse.or.jp](http://www.tse.or.jp)

**Assets under Management:** Adjustments over levels of assets under management, putting particular importance on the following points,

- Transfer of 10% or more of net assets.
- Profit or loss equivalent to 30% or more of that period’s gross profits that result from a transfer of assets.
- Loss equivalent to 3% or more of net assets as a result of natural disaster/damage.
- Expected profit or loss of 30% from original forecast; or dividends distribution difference of 20% from original forecasts.

In addition, details of the real estate properties held, as well as revenues from tenants, tenant details and operations of the assets.

**Financial Results:** Required to issue reports giving summaries of their financial results, including forecasts of dividends and the value of assets under management.

### JREIT TAXATION ISSUES<sup>7</sup>

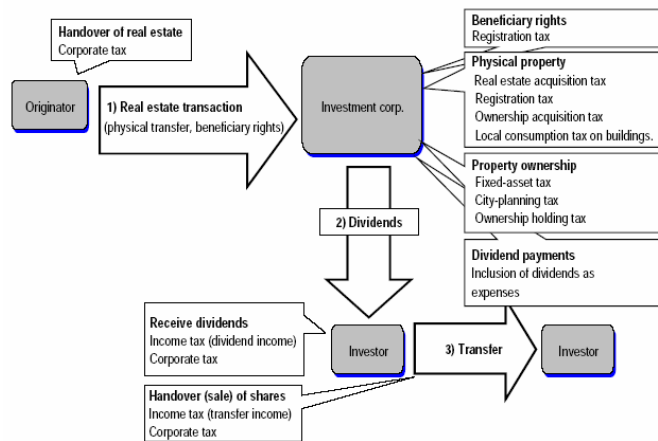
In general, taxes on dividends from JREITs are treated primarily the same as those from general equities. However, there are some unique rules for the JREIT market, as described below.

1) JREITs are not required to pay general acquisition fees and taxes typically associated with the purchase of real estate, such as property acquisition tax, registration and license tax, or special landholding tax, when certain conditions were met – which can be very costly in Japan.

2) JREITs can deduct dividends distributed to investors from their gross revenue in calculating corporate taxable income.

The taxation of JREITs is similar to equity taxation with some special features; exemption of JREITs (corporate-type) from real estate acquisition taxes and the deductibility of dividends paid in calculating corporate tax. For the investors the special features include the non-deductibility of dividends received in calculating taxable income.

Figure 40. Overview of J-REIT Tax System



Source: Association for Real Estate Securitization, Nikko Salomon Smith Barney Limited.

SOURCE: Nikko Salomon Smith Barney. “J-REIT Primer – A user’s guide to investing in Japanese REITs.” January, 2003.

The tax system for JREITs and secured real estate in Japan is split into three taxable actions. The first is the injection of the real estate into the fund (Corporate Tax). The second occurs at the distribution of dividends (Dividend Income Tax). The third, is the sale of stock ownership (Transfer Income Tax).

<sup>7</sup> [www.tse.or.jp](http://www.tse.or.jp)

## INTERVIEWS

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As an integral component to a convincing document it was determined that interviewing professionals in the JREIT market would be ideal to reinforce the assumptions and statements made herein. The following questions were drafted with the purpose of reiterating the overall real estate and economic market conditions as well as explore the attitude toward the JREIT market by those who are most closely associated with it.

Seven professionals in the JREIT market (at both the JREIT and underlying Operating Company level) were contacted and all seven agreed to participate in this exercise. The exchange was conducted via email correspondence. While the responses are considered personal opinion and not professional statements, all parties' identities will be protected and held with the utmost confidentiality. The following is a listing of the questions.

- 1) Who are buying the JREIT stocks now? Who is selling the JREIT stocks (If any)?
- 2) Yields are down to the 3% range, why is this enough yield?
- 3) At what point do you think the yields will bottom out?
- 4) One of the key valuation techniques for REITs is the P/NAV ratio. Where P is equal to the market value of outstanding stocks and NAV is equal to the estimated value of outstanding real estate equity per share of outstanding stock. My calculations on the current JREITs suggest that the P/NAV ratio is very high for all of the REITs, which strongly suggests that they are "over priced." Any comments?
- 5) How will the coming 2008 and 2010 Problem affect the JREITs?
- 6) Any indication the long-term government bonds will change?
- 7) Who is producing new REITs?
- 8) What are the motivations of those forming REITs?
- 9) Do you think there is a real estate price bubble?
- 10) Is it sustainable and when will the correction come?
- 11) Who will be hit the hardest when the correction comes?
- 12) Who is driving the 'bubble?' JREITs/Private Funds/"Funds of Funds"/RealEstate Firms?

While the questions were relatively simple in design the responses were generally well thought out and provided some very nice color to the conditions of the market.

The replies have been summarized in this section.

- 1) The primary buyers and holders of the JREIT stocks were unanimously identified at regional banks, life insurance firms, and other institutional investors who are financially pressed in the post-bubble economic recession to generate stable yielding investments.

However, since the securities law changed in spring of 2004, non-real estate funds and fund managers can now purchase and sell the JREIT stocks as part of their portfolios and securities products, also known as Fund of Funds (FOF). A major driver (although still dominated by the regional banks) in the demand now are these FOFs which are diversifying their portfolios with the addition of real estate in the form of JREIT stocks, and in some cases creating JREIT based portfolios for individual investors. Many of the FOFs are Trust Bank based and although they are buying the shares to meet the individual investor demands, the FOFs are statistically characterized as ‘Financial Institutions’ in reporting.

- 2) No other stable long-term investment generating a dividend in the 3% range is available in the market and that range is considered very attractive to investors. Higher yield can be achieved in the TSE, but the associated risks are considered much too high. Moreover, the spread between the Japanese Government Bonds (JGBs or the risk-free rate) and the JREITs is still very attractive, compared to the US REIT market and Australia.
- 3) The JREITs are considered “middle-risk-middle-return” investment products. Initially the earlier JREITs were generating yields that were 400-500 basis points above the risk-free rate, however the recent increase in demand has closed the gap to nearly 230 basis points. Arguably, this is due to the decrease in the required rate of yield by the investors and could go as low as into the 2% range. However, this is dependent upon competition in the market, possible changes in the risk-free rate, and alternative investments.
- 4) A number of other characteristics of an investment product should also be considered when evaluating an opportunity, such as 1) Higher liquidity than direct investment in real estate, 2) Lower volatility than stocks, 3) A reasonably high yield, 4) Ability to acquire small quantities (i.e. one share), 5) the quality of the Operating Firm. However, in considering the response to Q1, that the primary investors in the JREIT are regional banks, and institutional investors who are in need of liquid cash flow that can be achieved through the dividends that JREITs provide.
- 5) The issues related to the 2008-2010 problem, primarily those related to the expected retirement of a significant number of office employees are important to consider for real estate professionals. As a direct result the demand for office space may decrease, but those properly positioned in the market, i.e. the quality of the operating firm and the location of the assets, may not be affected dramatically. The quality of the operating company’s ability to lease and provide tenant services will also be critical going forward. As a result private real estate funds, not the JREIT, may be more negatively affected.
- 6) There is overall consensus that the current JGB yield is extremely low and that it won’t stay this way forever. However, no one is certain when or how much it will change; at least for the next coming year it will not likely be raised. If it does rise it will force an adjustment in the JREIT yields and be damaging to those who are issuing at lower initial yields; in the 3-4% range at IPO.
- 7) See later section “Expected New JREITs”

- 8) Some of primary reasons for listing a JREIT were expressed as the follows, 1) Moving real estate investments off the balance sheet, 2) to raise new investment funds, 3) equity investment play, 4) Development of a “Fee Business” (both fund and property management) 5) Expansion of strategic partner business (see keiretsu section), 6) to collect profits from asset sales (in the case of Mori Trust and the Fukuoka REIT), however this may have resulted in some negative backlash in general market opinion, 7) Improved transparency and notability in the market place.
- 9) The responses ranged from yes there is a bubble to no there is not bubble. The more elaborative responses included an assessment that real estate is a cyclical industry and as a result has its ups and downs. Currently income producing assets in the central Tokyo CBD are very competitive and pricing is going up quickly. However condominium residential assets are still falling in price. While prices are still rising, investor demand is still strong and therefore within normal ‘market’ parameters. If indeed there is a bubble it is limited and concentrated in certain areas, not all across the country. Nevertheless the current condition of the market, i.e. high demand and high prices, is considered to be sustainable for the near future.
- 10) Related to Q9, the future demands of investors is a key point on the future of the market. If rental rates begin to increase as the demand continues the market should not need any corrections. However, if only the prices continue to rise, then there is a possibility that a significant correction will occur. Regardless, if there is a major correction or not, the current high pricing is considered unlikely to continue and will stabilize or fall slightly. Moreover, the JREIT as a product is considered a buffer for investors and real estate players against a catastrophic change in the market.
- 11) If a correction comes the overall consensus was that it would not likely be a wide reaching adjustment that would affect the average Japanese and cause chaos in the market as did occur earlier in the 90s. But the hit would affect real estate investors and lenders. Specifically, those investors who are highly leveraged and over extended in secondary markets with lower quality assets. Also, the Private Fund players who are not long-term investors, and who will be looking to reposition their portfolios every three to five years, will suffer when they are need to sell their assets, if the demand is no longer there.
- 12) Again, the opinion on whether there is a bubble or not is mixed, but comments regarding the strong demand were given. The general opinion is that there are a lot of new players in the market; JREITs, Private Equity Funds, Fund-of-Funds, and Real Estate Companies) who are all competing. The JREITs are public and under much scrutiny from analyst and the TSE, so they are much less of a problem, because they are limited and arguably bound to operate within the box of the free and open market. However, the Private Equity player’s are extremely aggressive and are bound less by the fair market, but by the fact they must invest their targeted fund size or lose the funds for the next fiscal period. Nevertheless, considering the overall economy and the cyclical nature of real estate some of the opinions strongly suggested that the market may be on fire, but that it is part of the natural order of real estate.



## JREIT ANALYSIS

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In general, investors can evaluate the stocks of REITs and other publicly traded real estate companies using the same tools and techniques they use to assess the stocks of other public companies. In considering the current status of the JREIT market the following criteria, or points of note, were considered in determining the overall health of the market and valuation of the individual REITs. Some of those considered are listed below.

**PRICE / NET ASSET VALUE:** The current market capitalization of outstanding shares (P) and the net asset value or shareholder's equity (NAV) is an important indicator of REIT status. The difference reflects the stock market's current perception regarding the REIT's fundamental growth opportunities. If the REIT's share price exceeds its NAV, the stock market apparently perceives positive growth opportunities for the REIT.<sup>8</sup> Because NAV incorporates an estimate of the market value of a REIT's assets, most REIT analysts consider NAV rather than book value as a more appropriate measure of a REIT's net worth and calculate the ratio of price divided by NAV to determine share price premiums and discounts.<sup>9</sup>

**DIVIDEND YIELD / YIELD SPREAD OVER JGBs:** Considering the dividends per share price as compared with alternative investment vehicles, in particular the yield spread over long-term government bonds (JGB). JREITs payout some of the highest dividends in the market. These dividends are generated from the contractual rents paid by tenants that occupy the properties. Because these payment streams are based on a contract they are considered stable and predictable.

**JREIT RETURN ANALYSIS / PERFORMANCE WITH STOCK MARKET:** A brief comparison with some of the major Japanese stock indices and the performance of issued JREITs were conducted. Considered middle risk and stable, the JREITs have also demonstrated tremendous growth and total return over the past few years.

**PRICE vs. EARNINGS MULTIPLES:** A stock's P/E ("multiple") tells us how much investors are willing to pay per dollar of earnings. In general, growth stocks are defined by high P/E ratios and income stocks generally have low P/E ratios. However, simply comparing P/E ratios is not enough, it is important to also consider the Company's growth of the company and the overall industry.

**PRICE vs. FUNDS FROM OPERATIONS (FFO):** Funds from operations (FFO) is essentially the income from a firm's ongoing business operations. FFO in REITs is often equated loosely to net operating income (NOI) in direct property holdings; the typical REIT FFO represents levered equity operating income.<sup>10</sup> This ratio can be useful in comparing REITs among the Japan market as well as referring to the US market as a benchmark.

**ASSET COMPOSITION:** After having considered the overall market conditions and variations among locations and product type and size, the asset composition and investment strategies among the JREITs were considered.

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<sup>8</sup> David Geltner & Norman G. Miller. "Commercial Real Estate Analysis and Investments." South-Western Publishing. 2001.

<sup>9</sup> NAREIT. "Investing in Real Estate Investment Trusts." National Association of Real Estate Investment Trusts. November 2000.

<sup>10</sup> David Geltner & Norman G. Miller. "Commercial Real Estate Analysis and Investments." South-Western Publishing. 2001.

## **REITs: GROWTH STOCKS OR INCOME STOCKS?<sup>11</sup>**

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REITs are considered income stocks, not growth stocks, at least in the long run, for two fundamental reasons. First, in order to maintain their tax-exempt status, REITs are required to pay out 90% (as are JREITs) of their annual book earnings as dividends. This restricts to some degree the ability of some REITs to retain earnings for reinvestments. More important, however, the fundamental nature of real estate as an underlying asset dictates the income-oriented nature of most REITs, at least those that do not own much raw land or development rights. Stabilized operational commercial properties are, by their very nature, income-oriented assets, not growth-oriented assets. In general, the only major type of real estate asset that offers long-run maintainable growth stock characteristics is raw land or other such development rights.

In reviewing the information of the current JREITs and their unique asset composition and stated investment strategy, none of those listed are strategically positioned as 'growth stocks,' based on the above definition.

## **FUNDAMENTAL NATURE AND VALUE OF REITs: TWO MODELS<sup>12</sup>**

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The Dual Asset Market assumption is one aspect related to the growth versus income question in which the REIT industry is rather unique. Apart from idiosyncratic growth specific to individual firms, all REITs in general will occasionally face periods of growth opportunity because of a unique feature of real estate that distinguishes REITs from most other non-real-estate firms that trade in the stock market.

This is the real estate's unique dual asset market situation, in which two parallel markets exist for trading real estate assets: the private property market and the stock market. The key point to make is that the stock market valuation of property and the private property market valuation of property are not always consistent.

The stock market sometimes values properties more highly than the property market does, and other times the reverse is true. However, in the long run, the two markets tend to agree; the ability of capital to flow from one market to the other ensures that such agreement will tend to occur on average over the long run. But in the short run, often, in historical experience, for periods lasting up to several years, the two markets may disagree about value. This disagreement can occur in either direction, but in general, when it occurs, the REIT market tends to be ahead of the private property market in time.

In other words, after a period typically ranging from one to three years in historical experience, the property market often follows in the direction in which the REIT market previously led.

When the stock and property markets disagree about property value, REITs face either positive or negative NPV opportunities from buying properties at market value in the property market. When the stock market values property more highly than the private property market does, REITs can grow merely by buying properties, and this can turn most REITs temporarily into growth stocks.

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<sup>11</sup> David Geltner & Norman G. Miller. "Commercial Real Estate Analysis and Investments." South-Western Publishing. 2001.

<sup>12</sup> David Geltner & Norman G. Miller. "Commercial Real Estate Analysis and Investments." South-Western Publishing. 2001.

## P/NAV ANALYSIS

Investors often judge the relative value of a stock by dividing the market price of the stock by the book value per share of the company. A company's book value is the difference between the company's assets and liabilities or the sum of retained earnings plus other items under stockholders' equity. It is used to determine how much more or less investors are willing to pay for the book net worth of the company and the earnings capacity that the net worth represents. Most REIT analysts and investors consider price-to-book value ratios as inappropriate when evaluating REITs. Because a REIT's real estate assets are valued at their original purchase price less accumulated depreciation, book value accounting may significantly understate the current market value of the REIT's properties and the genuine earnings capacity of the company. Thus, most REIT analysts and investors use current real estate prices to estimate a REIT's net asset value (NAV) as a surrogate for book value.<sup>13</sup>

### P/NAV of Current Listed JREITs

Code	Abr. Name	Stock/Unit Price (as of 6/29) (JPY)	Shares Outstanding (as of 4/2005)	Mkt CAP (JPY)	Shareholder's Equity (JPY)	P/NAV*
8951	NBF	999,000	364,700	364,335,000,000	216,985,000,000	1.679
8952	JRE	939,000	345,400	324,330,600,000	137,569,000,000	2.358
8953	JRF	954,000	279,502	266,644,908,000	119,573,000,000	2.230
8954	OJR	792,000	175,372	138,894,624,000	88,288,000,000	1.573
8955	JPR	323,000	530,000	171,190,000,000	91,982,000,000	1.861
8956	PIC	710,000	79,400	56,374,000,000	38,253,000,000	1.474
8957	TokyuRE	800,000	142,000	113,600,000,000	79,712,000,000	1.425
8958	GO	884,000	76,400	67,537,600,000	47,379,000,000	1.425
8959	NOF	838,000	229,970	192,714,860,000	94,774,000,000	2.033
8960	UUR	709,000	159,843	113,328,687,000	40,194,000,000	2.820
8961	MoriTrust	1,020,000	160,000	163,200,000,000	82,798,000,000	1.971
8962	NichiResidence	641,000	142,845	91,563,645,000	25,356,000,000	3.611
8963	TGR	399,000	28,899	11,530,701,000	7,082,000,000	1.628
8964	FRI	729,000	110,400	80,481,600,000	59,636,000,000	1.350

8965, 8966, 8967, 8968 are not included due to lack of information.

\* Where P is equal to the 6/29 unit price x the outstanding shares and the NAV is equal to the published acquisition value of the real estate on the ARES web site.

When the P/NAV (PBR) ratio exceeds 1.0, the stock is said to trade at a premium to book value and when the ratio is below 1.0, the stock trades at a discount. Stocks that trade at a discount often are viewed as offering investors more value than stocks priced at a premium. As demonstrated in the above chart all of the current JREITs are trading at a premium. Which suggests that from the JREITs perspective there is an arbitrage opportunity in the property market; that is, for every 1 yen spent in the property market (i.e. in the acquisition of a new property) the REIT can borrow from the stock market, 1.67 yen (taking NBF as an example).

This can be attributed to three possible things,

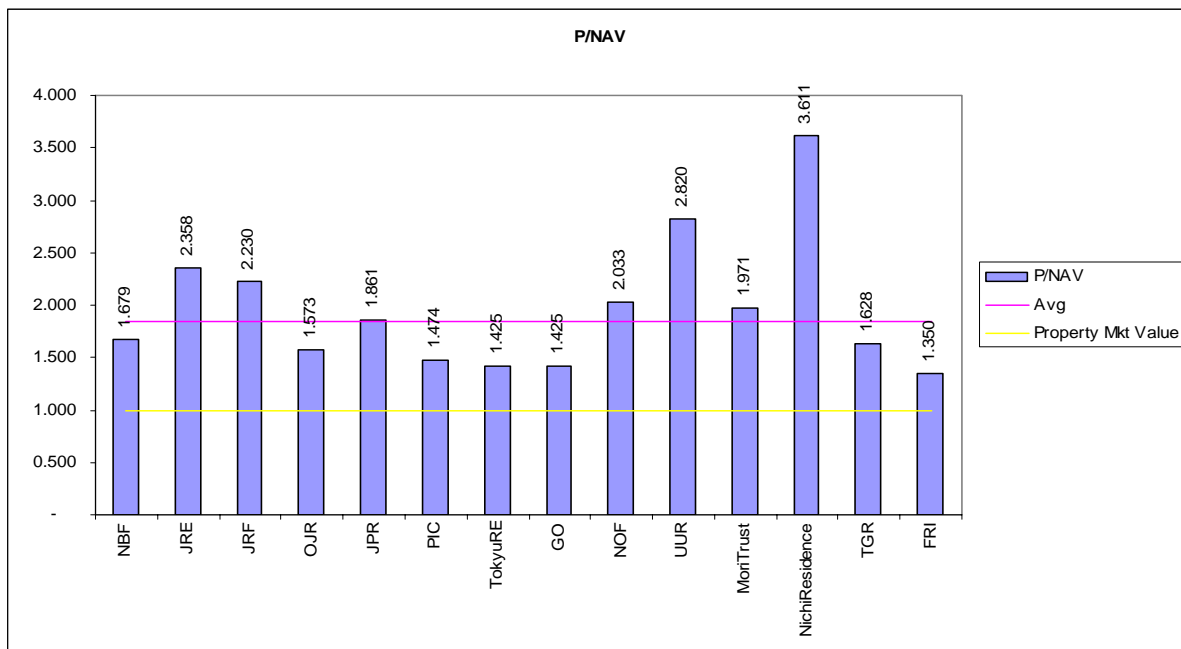
1) The stock market is applying a premium to the management skills and abilities of the operating company. Corporate reputation in Japan is highly prized and extremely important. Much of the premiums may be attributed to this strong characteristic of Japanese business tradition. From such

<sup>13</sup> NAREIT. "Investing in Real Estate Investment Trusts." National Association of Real Estate Investment Trusts. November 2000.

reputations and corporate relationships entities can leverage stronger positions in the market and acquire opportunities that other less networked firms would otherwise not have access to.

2) The JREIT is involved with development projects; invested in real estate that has yet to generate income due to development time; the market prices the stock to a level anticipating the future value of these development opportunities. JREITs can invest up to 25% of their asset allocation to development projects, but only JRF and JRE have pursued development projects and to a very limited scale. While others, such as ORIX JREIT Inc. (ORJ); while not investing directly into development projects, ORJ has a stated strategic relationship with the ORIX Group (a medium-sized office property developer) (see also the keiretsu concept in previous chapters) that is developing assets with the purpose of being injected into the REIT. Arguably, some of the premiums may be attributed to such strategic alliances and “development projects,” although it is difficult to quantify due to limited transparency between organizations.

3) The market has an over zealous outlook and too much demand has made the stock overpriced.



According to the Tokyo Stock Exchange’s “Average Consolidated PER and PBR by Size and Types of Industry” as of May 2005, some industries showed the follow PBRs (the stock equivalent to P/NAV). (Not including companies on the Mother’s Index).

**PBR of Japan Industries**

Industry	PBR
Banks	1.1
Insurance	1.1
Real Estate	1.8
Composite	1.3
Large	1.8
Medium	1.6
Small	1.2

## DIVIDEND YIELD AND JGB SPREAD

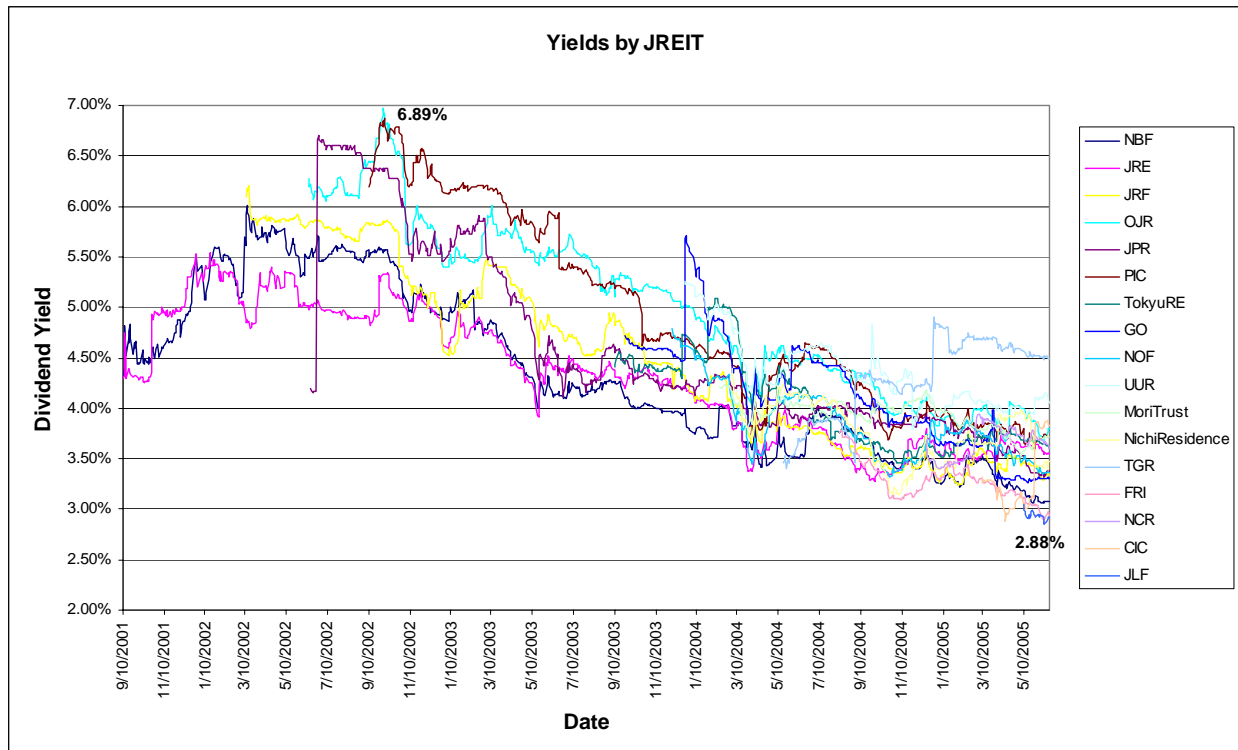
Code	Name	Yields
8951	NBF	3.08%
8952	JRE	3.55%
8953	JRF	3.33%
8954	OJR	3.80%
8955	JPR	3.37%
8956	PIC	3.71%
8957	TokyuRE	3.59%
8958	GO	3.30%
8959	N O F	3.36%
8960	UUR	4.05%
8961	MoriTrust	3.71%
8962	NichiResidence	3.47%
8963	TGR	4.49%
8964	FRI	2.93%
8965	NCR	3.61%
8966	CIC	3.83%
8967	JLF	2.92%
8968	FRC	-

### Current Yields by JREIT

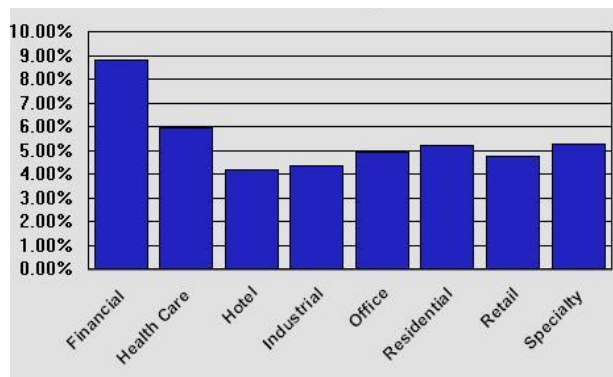
Using the market capitalization levels of each JREIT, as of 6/17/2005, the weighted average yield of the JREIT market is estimated at 3.44%; with a maximum yield of 4.5% (TGR) and a minimum yield of 2.88% (JLF). It is important to note that the JLF REIT is very new and in general the initial yields are lower than normal due to the initial expenses related to going public.

It appears that the market is driving the yields downward to a range between 3%-4%, which is 170 to 270 basis points above the current government bonds.

While the current JREITs have only been on the market for a few years, their management styles and investment policies significantly vary. However, the yields that the market is driving the prices to show very little differentiation among the JREITs; as the yield range is approximately 150 basis points.



\* The sharp jumps in yield are generally due to the initial costs of taking the fund public; as a result it is generally a better indication of initial yield performance after the first financial period and when the IPO costs have been absorbed.

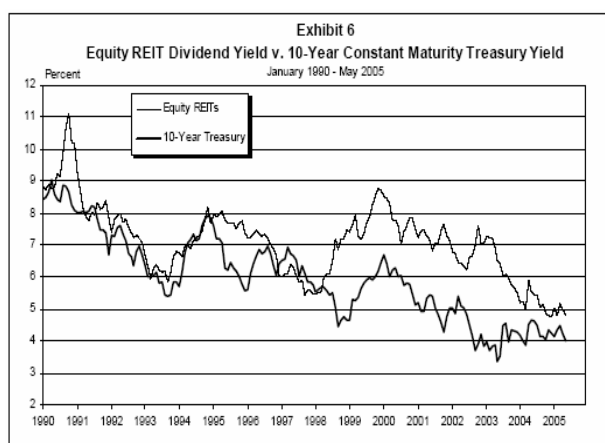


US REIT Average Yields

SOURCE: [www.atlantisinvestment.net](http://www.atlantisinvestment.net)

Financial REIT yields offer income investors the highest current return. Hotel REIT yields are still below the average for all REITs. REIT yields have decreased since April, 2005, as REIT stock prices have increased.

Average yield for all REITs as of May, 2005 is 5.45% (approximately 200 basis points above those in the JREIT market).



SOURCE: NAREIT. "REITWatch. A Monthly Statistical Report on the REIT Industry." National Association of Real Estate Investment Trusts. June 2005.

Historically, in the US REIT market equity REITs and the 10-year treasury bonds have shown a high level of correlation. In fact, until 1998 both were virtually identical. However, over the past eight years a spread between the two has developed and held consistently between 100 and 200 basis points, and is now slightly less than 100 basis points.

It is difficult to suggest that this is a global standard for this market, but it is important to note. In this case, using this as a benchmark, the JREIT market yields hold around 3.44% with downward pressure against the Japanese 10-year Government Bonds at 1.3%; a spread of 200 basis points. Arguably, this suggests that the JREITs are priced in a legitimate range compared to the JGB.



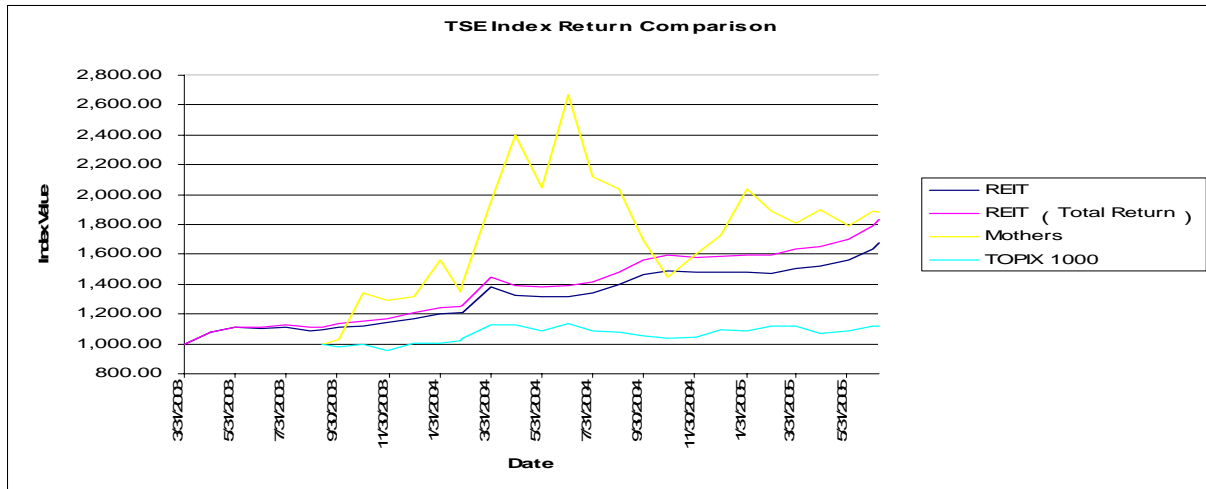
The 10-year JGB Yields (1976-2004).

SOURCE: The Ministry of Finance of Japan. "Guide to Japanese Government Bonds 2004." Ministry of Finance. 2004.

The Japanese Government Bonds (JGB) generate currently around a 1.26% yield. Down from nearly 10% in 1980 and on a continually decreased since 1991. If interest rates were raised to any significant levels the resulting affect on the JREIT market could dramatic.

As the JGBs continue to yield low returns and the stock market holds high volatility, the JREITs will likely, regardless of management, debt levels, asset allocation, or other characteristics considered relevant in the US REIT market, fall in between the range of 2.5% to 4% yield, keeping a risk premium above the JGBs of 100 to 250 basis points. Until, that is, the market begins to show signs of differentiating among the JREITs. Currently, all JREITs are considered equal, however as more are issued the investors will have more options and therefore become more selective in choosing an investment. Eventually, a larger spread among the JREIT (based on management, debt levels, asset allocation, etc) will develop.

## JREIT RETURN ANALYSIS



We can clearly see from this comparison that the JREIT market is generating powerful returns with significantly less volatility than the stock market. While the Mothers index climbed quickly in 2004 it corrected by the end of the year and is now, over the last two years, providing a return only slightly higher than the JREIT Index, but not necessarily high enough to justify the associated volatility. Such volatility is less desirable for conservative investors, like the Japanese, and motivates them to consider more stable options with less or similar levels of returns; in this case, such as JREITs. In addition, the TOPIX 1000 has done little to attract investors.

The Tokyo Stock Exchange REIT Index (**REIT**) is a capitalization-weighted index based on all JREITs listed on the TSE and is calculated with the same methodology used for the calculation of TOPIX (Tokyo Stock Price Index). The TSE REIT Index is the ratio of the current market value (CMV) to the base market value (BMV) at the time of calculation; it is calculated by multiplying 1,000 by the figure obtained by dividing the CMV, which is the sum of the products of the price and the number of listed JREITs for calculation of indices (NREIT) of each component JREIT, by the BMV (the obtained value is the rounded off to the nearest one hundredth).<sup>14</sup>

The Tokyo Stock Exchange Mothers Index (**Mothers**) is a market capitalization-weighted index based on all stocks listed on Mothers (On November 11, 1999, Tokyo Stock Exchange established a new market named Mothers (market of the high-growth and emerging stocks) and is calculated with the same methodology used for calculation of TOPIX (Tokyo Stock Price Index).<sup>15</sup>

TOPIX 1000 (**TOPIX 1000**) is a market capitalization-weighted index and its component stocks are reviewed annually according to market capitalization and liquidity on the 1st section of the TSE. Thus, TOPIX 1000 is an appropriate index especially for fund managers who wish to track the Japanese market. It includes the Core30 (The 30 most liquid stocks with largest market capitalization.), the Large 70 (After the Core 30, the 70 most liquid and highly market capitalized shares.), the Mid 400 (The remaining 400 shares in the TOPIX 500.), and the Small (The remaining stocks, outside the TOPIX 500). The correlation between TOPIX 1000 and TOPIX is expected to be extremely high.<sup>16</sup>

<sup>14</sup> [www.tse.or.jp](http://www.tse.or.jp)

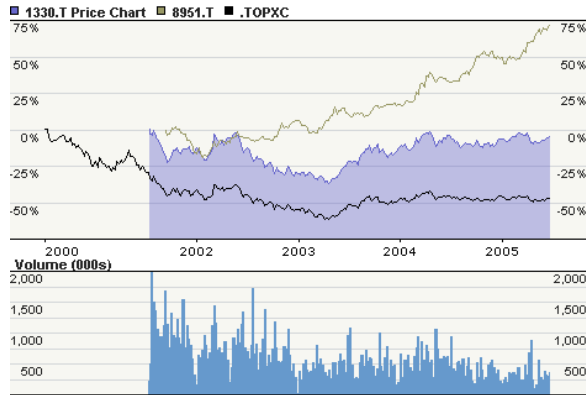
<sup>15</sup> [www.tse.or.jp](http://www.tse.or.jp)

<sup>16</sup> [www.tse.or.jp](http://www.tse.or.jp)

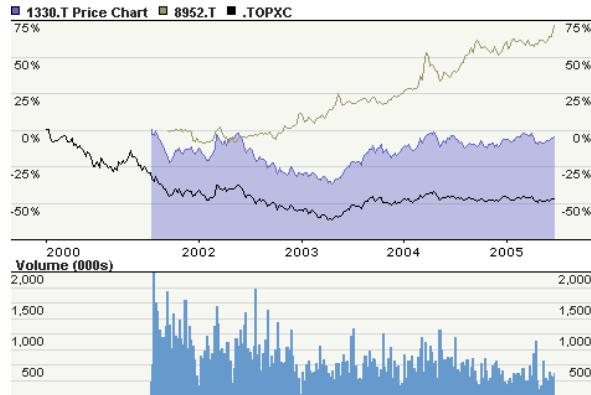
1330.T: Nikkei Index (a price weighted average of 225 companies on the TSE)

89xx.T: JREIT

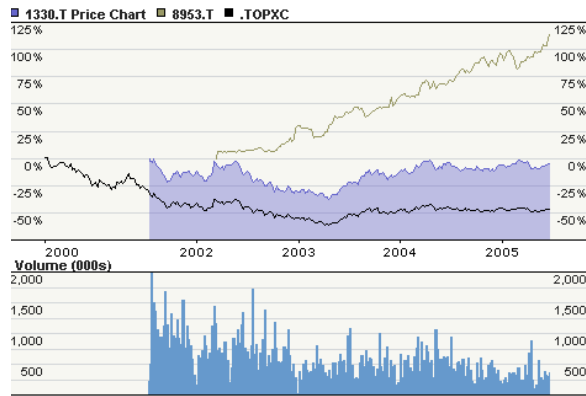
TOPXC: Tokyo Stock Exchange 30 Index (the 30 most liquid and highly market capitalized shares)



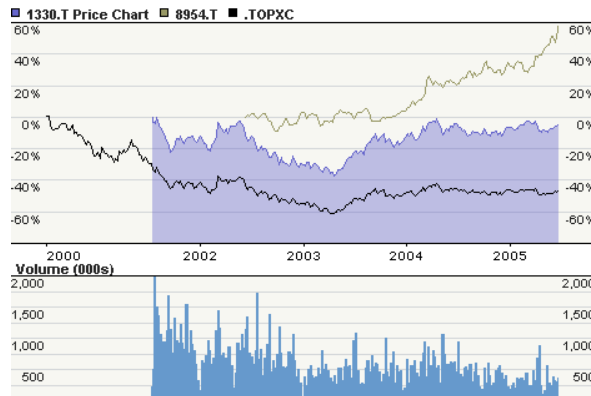
8951: NBF



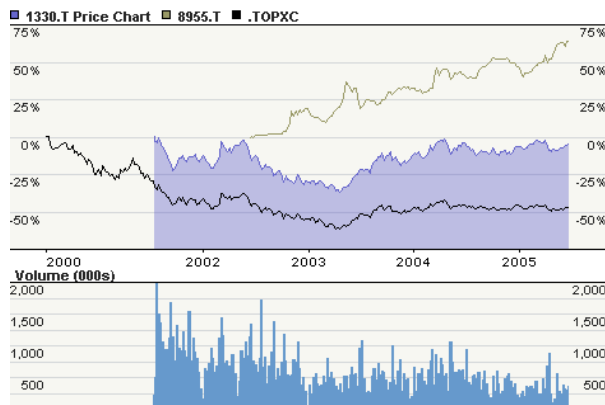
8952: JRE



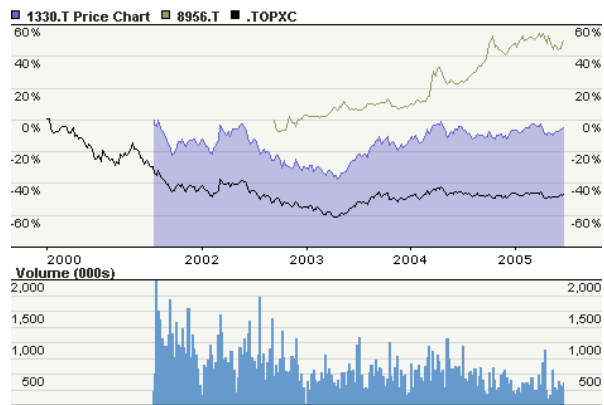
8953: JRF



8954: OJR



8955: JPR



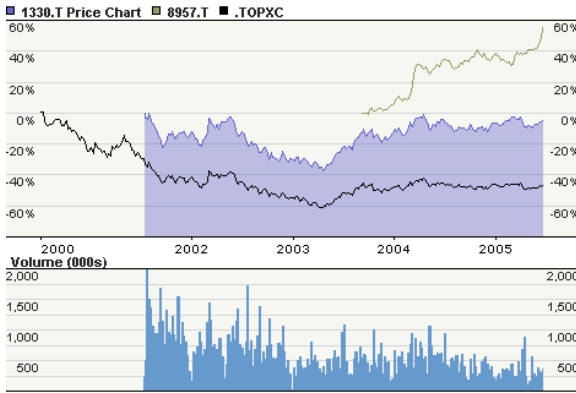
8956: PIC



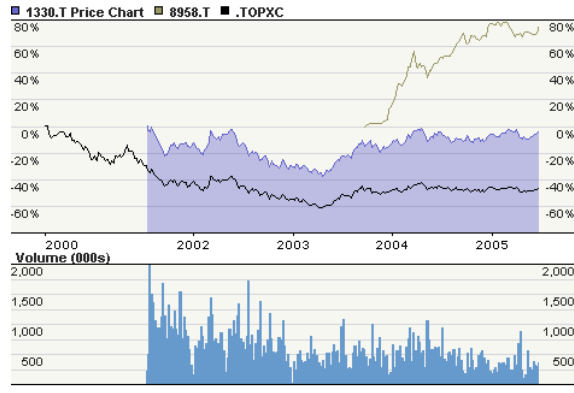
1330.T: Nikkei Index (a price weighted average of 225 companies on the TSE)

89xx.T: JREIT

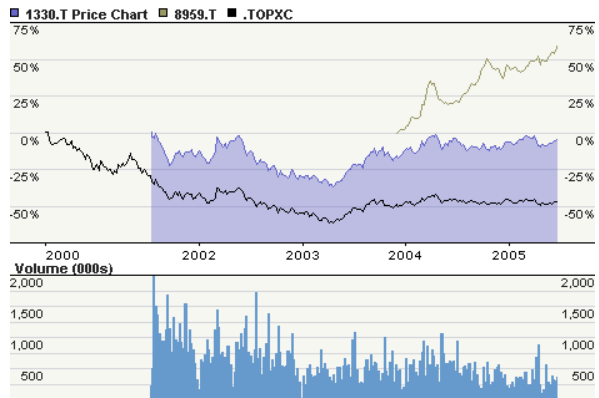
TOPXC: Tokyo Stock Exchange 30 Index (the 30 most liquid and highly market capitalized shares)



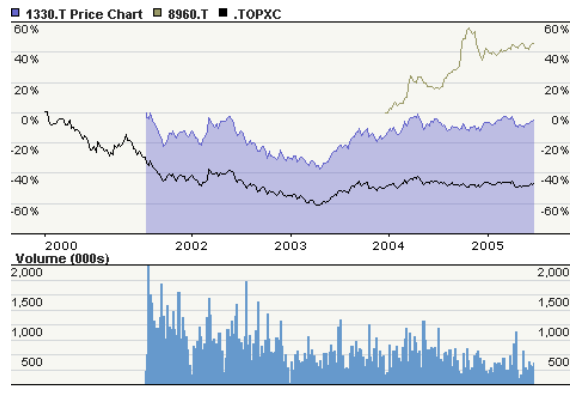
8957: TokyuRE



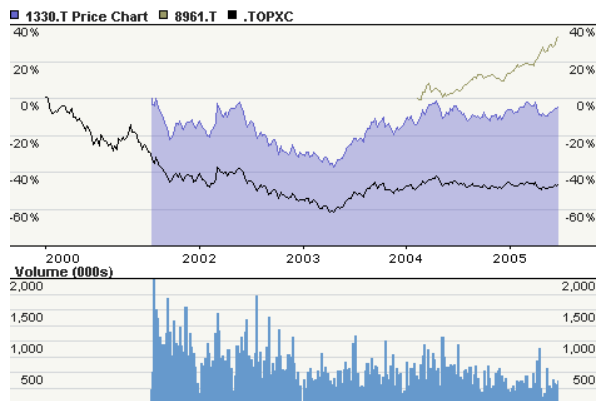
8958: GO



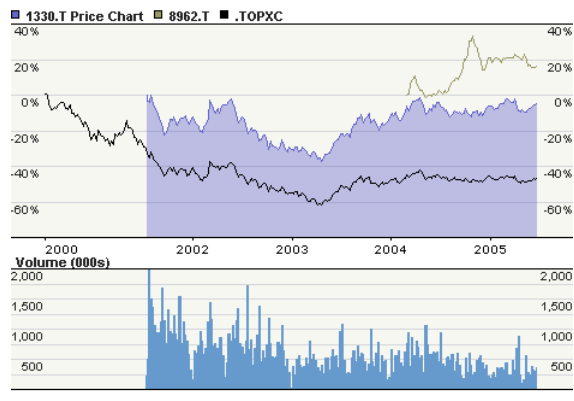
8959: NOF



8960: UUR



8961: MoriTrust

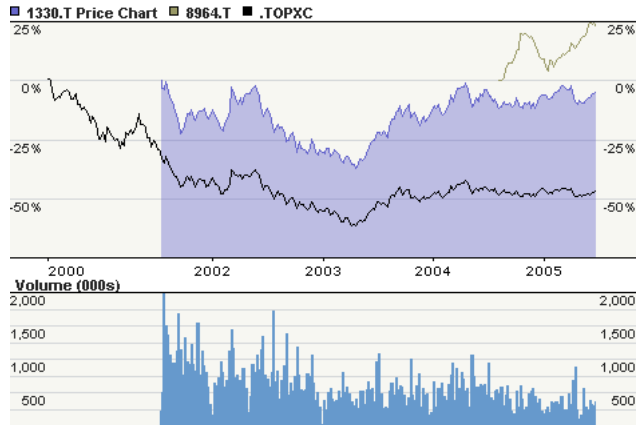


8962: NichiResidence

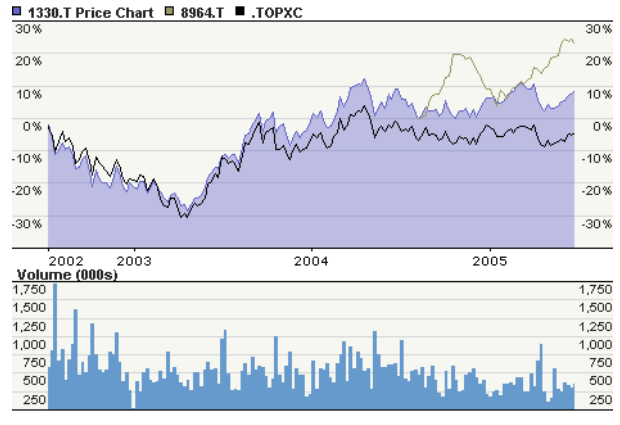
1330.T: Nikkei Index (a price weighted average of 225 companies on the TSE)

89xx.T: JREIT

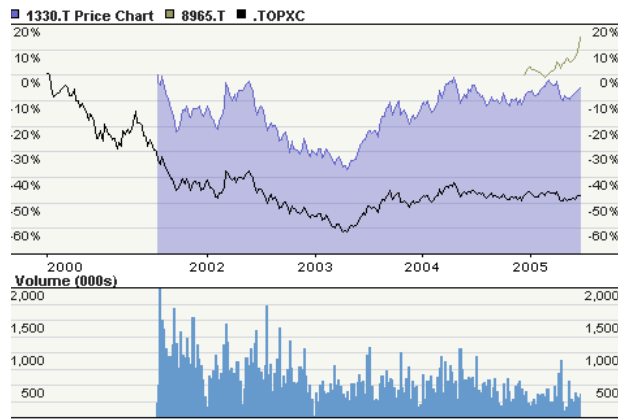
TOPXC: Tokyo Stock Exchange 30 Index (the 30 most liquid and highly market capitalized shares)



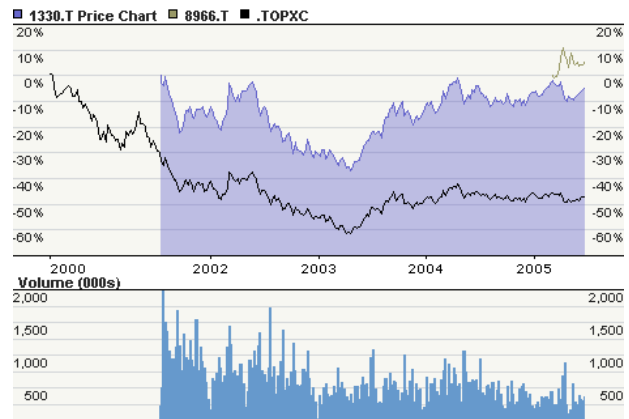
8964: FRI



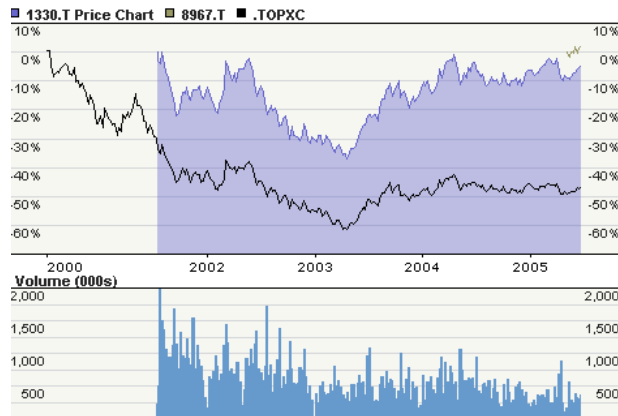
8965: NCR



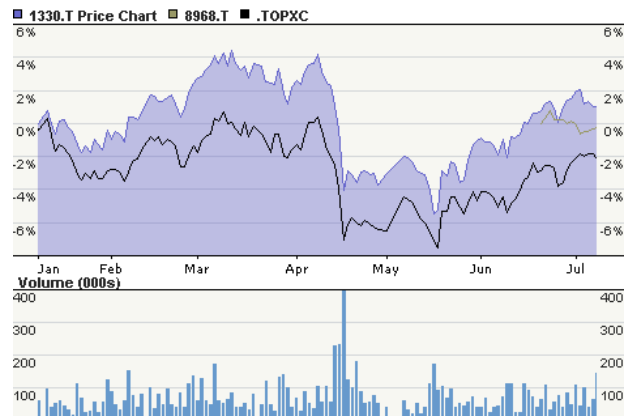
8965: NCR



8966: CIC



8967: JLF



8968: FRC

## PRICE VS. EARNINGS MULTIPLE

Historically, the average P/E ratio in the US market has been around 15-25. This fluctuates significantly depending on economic conditions at the time. The P/E can also vary widely between different companies and industries. In the US the P/E ratios for REITs and real estate firms are listed below,

### US REIT P/E Ratios by REIT Type

Industry	P/E
REIT - Diversified	16.8
REIT - Healthcare Facilities	19.5
REIT - Hotel/Motel	73.5
REIT - Industrial	28.0
REIT - Office	28.3
REIT - Residential	17.3
REIT - Retail	29.9

A stock's P/E tells us how much an investor is willing to pay per dollar of earnings.

A P/E ratio of 20 suggests that investors in the stock are willing to pay \$20 for every \$1 of earnings that the company generates.

SOURCE: P/E Ratios by Industry on Yahoo Finance (average 31.7)

Although the EPS figure in the P/E is usually based on earnings from the last four quarters, the P/E is more than a measure of a company's past performance. It also takes into account market expectations for the growth of a company. Stock prices reflect what investors think a company will be worth. Future growth is already accounted for in the stock price. As a result, a better way of interpreting the P/E ratio is as a reflection of the market's optimism concerning a company's growth prospects. The P/E ratio is a much better indicator of the value of a stock than the market price alone.<sup>17</sup>

### P/E Multiples and EPS Projection for Currently Issued JREITs

Code	Abr. Name	Stock/Unit Price (as of 6/29) (JPY)	Mkt CAP (JPY)	Shareholder's Equity (JPY)	EPS (12/2004) (JPY)	P/E Multiple	Projected EPS (First of 2005) (JPY)	EPS Growth	P/E Multiple
8951	NBF	999,000	364,335,000,000	216,985,000,000	17,607	56.7	15,100	-14%	66.2
8952	JRE	939,000	324,331,000,000	137,569,000,000	15,824	59.3	15,800	0%	59.4
8953	JRF	954,000	266,645,000,000	119,573,000,000	15,419	61.9	14,565	-6%	65.5
8954	OJR	792,000	138,895,000,000	88,288,000,000	14,068	56.3	14,323	2%	55.3
8955	JPR	323,000	171,190,000,000	91,982,000,000	6,671	48.4	5,800	-13%	55.7
8956	PIC	710,000	71,994,000,000	38,253,000,000	15,105	47.0	14,000	-7%	50.7
8957	TokyuRE	800,000	113,600,000,000	79,712,000,000	13,111	61.0	13,300	1%	60.2
8958	GO	884,000	67,537,000,000	47,379,000,000	22,891	38.6	14,100	-38%	62.7
8959	NOF	838,000	192,714,000,000	94,774,000,000	14,114	59.4	14,000	-1%	59.9
8960	UUR	709,000	113,328,000,000	40,194,000,000	19,090	37.1	13,600	-29%	52.1
8961	MoriTrust	1,020,000	163,200,000,000	82,798,000,000	17,493	58.3	18,000	3%	56.7
8962	NichiResidence	641,000	91,563,000,000	25,356,000,000	18,441	34.8	12,108	-34%	52.9
8963	TGR	399,000	11,530,000,000	7,082,000,000	14,849	26.9	9,011	-39%	44.3
8964	FRI	729,000	80,481,000,000	59,636,000,000	9,688	75.2	10,778	11%	67.6
8965	NCR	683,000	50,921,000,000	-	-	-	15,112	NA	45.2
8966	CIC	574,000	26,858,000,000	-	-	-	6,260	NA	91.7
8967	JLF	721,000	42,899,000,000	-	-	-	15,453	NA	46.7
8968	FRC	890,000	80,144,000,000	-	-	-	18,116	NA	49.1

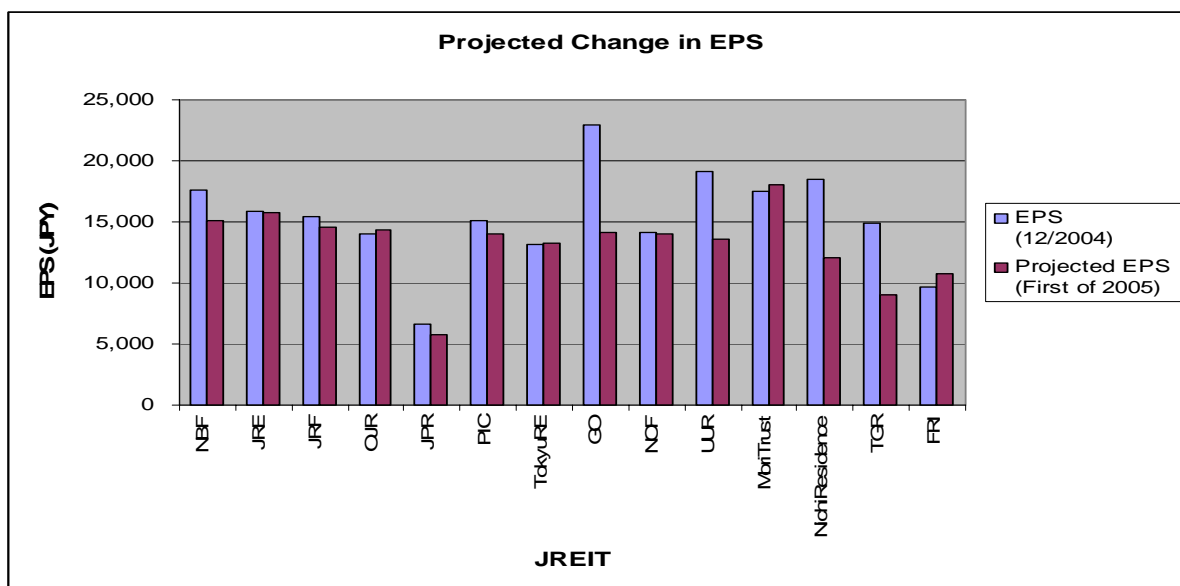
<sup>17</sup> [www.Investopedia.com](http://www.Investopedia.com)

The P/E ratio is really just an inverse of the yield analysis for REITs. That being the case, since the yields for the US market are approximately 5.4% and the yield for the Japanese market are 3.4%, then it would seem logical that the P/E ratios for the JREITs should be approximately twice that of the US REITs. The JREIT P/E ratios range from 44.3 to 91.7, while the US REITs range from 17 to 73. This seems consistent, but is it high or low? It's difficult to determine whether a particular P/E is high or low without taking into account two main factors:

**Industry** - It is only useful to compare companies if they are in the same industry. For example, utilities typically have low multiples because they are low growth, stable industries. In contrast, the technology industry is characterized by phenomenal growth rates and constant change. Comparing a tech to a utility is useless. You should only compare high growth companies to others in the same industry, or to the industry average. You can find P/E ratios by industry on Yahoo Finance.<sup>18</sup> In this case we are considering only REIT related companies.

**Company growth rates** - How fast has the company been growing in the past, and are these rates expected to increase or at least continue into the future? Something isn't right if a company has only grown at 5% in the past and still has a stratospheric P/E. If projected growth rates don't justify the P/E, then a stock might be overpriced. In this situation, all you have to do is calculate the P/E using projected EPS.<sup>19</sup> Rapid earnings growth is an important attribute of successful companies. However, consistent earnings growth also is important and highly valued by investors. When buying common stocks, investors should focus on future earnings growth, as much as on past performance, and ask themselves where future earnings growth will come from.<sup>20</sup>

It is critical to note that the high P/E ratios of the JREIT market are not justified by the 'growth rates' as demonstrated above/below. In fact, the majority of JREITs are projecting decreases in the levels of EPS during the next term. As a result, the next term projected P/E ratios are on the rise. This should be a point of concern for investors or those interested in JREITs.



Limited to those JREITs where EPS projections were available.

<sup>18</sup> NAREIT. "Investing in Real Estate Investment Trusts." National Association of Real Estate Investment Trusts. November 2000.

<sup>19</sup> NAREIT. "Investing in Real Estate Investment Trusts." National Association of Real Estate Investment Trusts. November 2000.

<sup>20</sup> NAREIT. "Investing in Real Estate Investment Trusts." National Association of Real Estate Investment Trusts. November 2000.

## PRICE vs FFO

JREITs report their net income and earnings per share (EPS) using generally accepted accounting principles (GAAP). However, GAAP requires that commercial property owners depreciate the cost of their properties to zero even though well-located and well-maintained properties continue to be highly valuable after 20, 30, or 40 years. Therefore, most REIT analysts and investors consider the traditional GAAP-based measure of net income to be inadequate for properly evaluating the operating performance of real estate companies because the large depreciation charges are widely believed to significantly overstate expenses and understate earnings. To account for this shortcoming, NAREIT in 1991 adopted funds from operations or FFO to promote an industry-wide measure of REIT operating performance that would not have this drawback. FFO is intended to be a supplemental measure of earnings, and primarily adds back depreciation and real estate amortization charges to GAAP net income, while it excludes gains (or losses) from property sales. Individual investors need not be experts in computing FFO. Rather, they need only understand that it is a commonly accepted measure of operating performance in the REIT industry.<sup>21</sup>

### P/FFO for Currently Issued JREITs

Code	Abr. Name	Stock/Unit Price (as of 6/29) (JPY)	Shares Outstanding	Mkt CAP (JPY)	FFO (JPY)	P/FFO
8951	NBF	999,000	364,700	364,335,000,000	18,394,000,000	19.8
8952	JRE	939,000	345,400	324,330,600,000	11,524,000,000	28.1
8953	JRF	954,000	279,502	266,644,908,000	10,134,000,000	26.3
8954	OJR	792,000	175,372	138,894,624,000	6,934,000,000	20.0
8955	JPR	323,000	530,000	171,190,000,000	8,520,000,000	20.1
8956	PIC	710,000	79,400	56,374,000,000	3,614,000,000	15.6
8958	GO	884,000	76,400	67,537,600,000	4,229,000,000	16.0
8959	NOF	838,000	229,970	192,714,860,000	7,409,000,000	26.0
8960	UUR	709,000	159,843	113,328,687,000	4,028,000,000	28.1
8961	MoriTrust	1,020,000	160,000	163,200,000,000	6,756,000,000	24.2
8964	FRI	729,000	110,400	80,481,600,000	3,951,000,000	20.4

\* 8957, 8962, 8963, 8965, 8966, 8967, 8968, were not included due to limited information

Based on a weighted average of the JREIT market capitalization levels the average P/FFO for the Japanese REIT industry is 19.2, and ranges from 15.6 to 28.1. In the US REIT market the P/FFO ratios for 2004 ranged from 13.1 to 18.3 and in the 2005 projections are between 12.0 and 14.6.

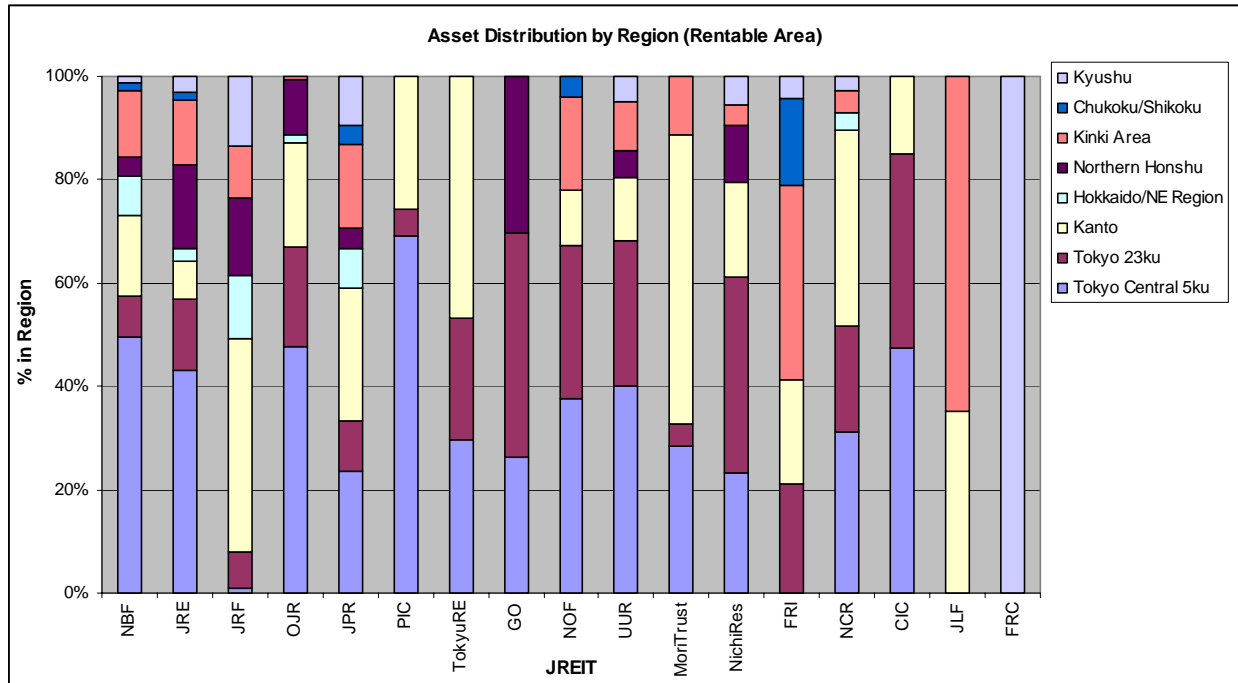
### US P/FFO Ratio by Property Sector

Property Sector	P/FFO Ratio (Average)	
	2004	2005
Office	13.6	12.0
Industrial	15.2	13.8
Mixed (office/industrial)	13.1	12.3
Shopping Centers	13.7	12.8
Regional Malls	13.0	11.7
Free Standing	13.6	13.3
Apartments	15.7	14.6
Manufactured Homes	18.3	13.6

SOURCE: "REITWatch. A Monthly Statistical Report on the REIT Industry." National Association of Real Estate Investment Trusts. June 2005.

<sup>21</sup> NAREIT. "Investing in Real Estate Investment Trusts." National Association of Real Estate Investment Trusts. November 2000.

## JREIT COMPOSITION BY REGION

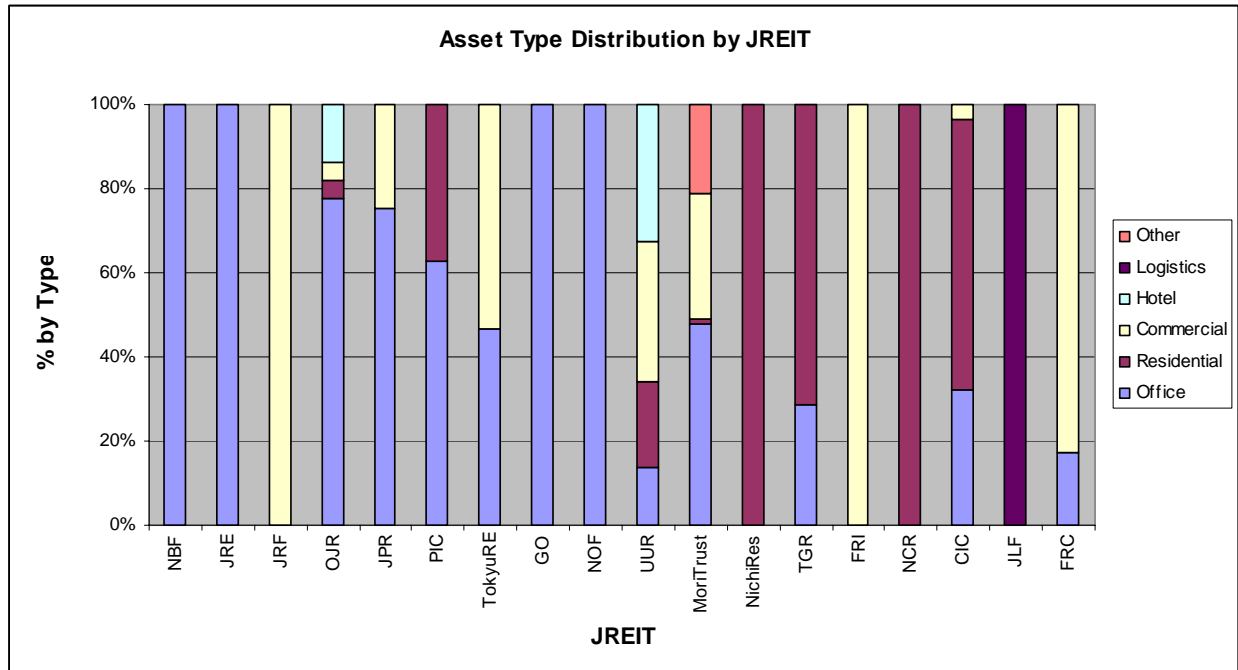


Recalling the market materials covered in previous sections, the strongest and most stable real estate market is by far that of Tokyo, and more specifically within Tokyo’s central 5ku. JREIT operators who are long in this region are more likely to hold long-term stability in pricing and rent generation. Knowing well the importances of the Tokyo region, the majority of JREITs are invested nearly 60% in the Tokyo region, including the 5ku and 23ku areas. However, some still chose to pursue investments in other regions.

JLF is an logistics and industrial specific REIT which limits its ability to invest in the Tokyo region; the cost of real estate within Tokyo has resulted in the majority of warehouse and distribution centers of any significant size and status to locate in areas outside the city.

FRC is a regionally specific REIT, which focuses on the Fukuoka and Kyushu region. The investors, operators and major unit holders are regionally based and therefore strategically positioned to leverage the ‘weaker’ market.

## JREIT COMPOSITION BY ASSET TYPE



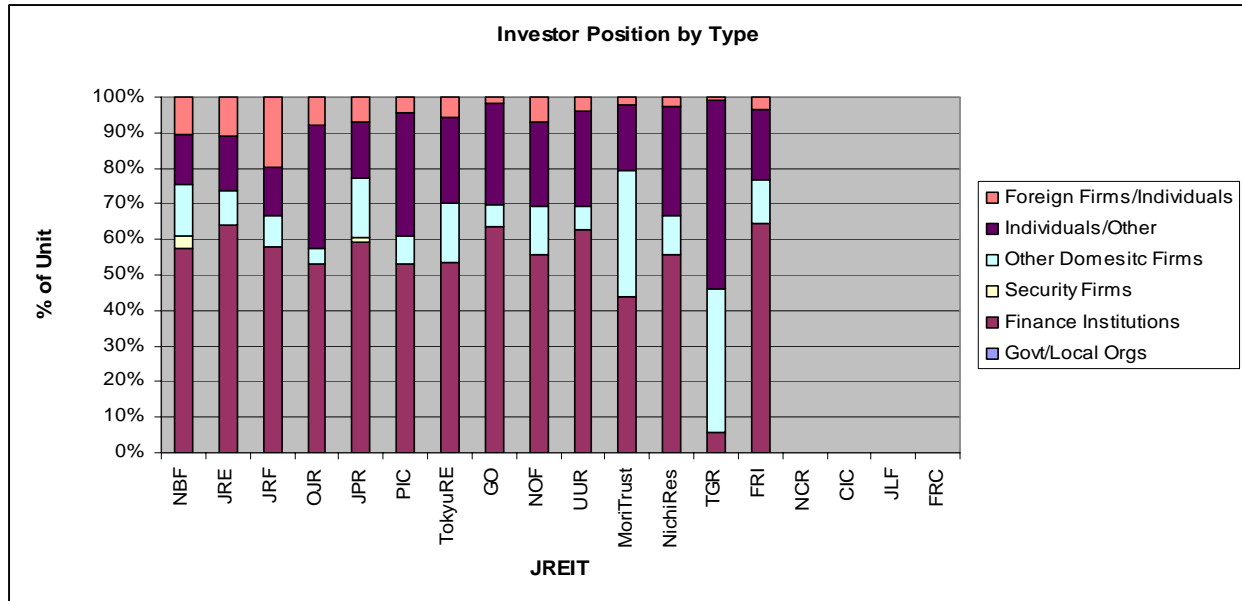
The Japan industry is broken up by four office REITs, one commercial REIT, two residential REITs, one logistics REIT, and nine mixed REITs. The concept of specialization in management and property type can be summarized by the following process that the US REIT market went through,

A prominent characteristic of REIT management strategy during the 1990s, one that distinguished the new REITs of that decade from the older ones, was the tendency of REITs to specialize or focus on one type of property. Earlier REITs had often been diversified by property type. The idea was that the REIT's investors would want a diversified portfolio of properties. This may have made some sense when REITs were viewed as passive investment vehicles, but in fact, REIT investors can diversify on their own by buying different types of REIT stocks, and types of diversification decisions themselves. Furthermore, once REITs became more actively managed entities, it became clear that management expertise could usually be more effective when it was specialized by property type. Also, perhaps more important, the stock market can more easily understand and analyze a REIT that is specialized into one of a few somewhat standard space market segments. Led by health-care REITs in the late 1980s, REITs in the 1990s tended to specialize in fields such as apartments, shopping malls, smaller retail centers, hotels, and office and industrial properties. Smaller, more unique niches have also been developed, such as self-storage, manufactured housing, golf courses, and others.<sup>22</sup>

Reviewing the pipeline going forward many of the new JREITs will likely be specialized REITs that focus on one specific property type, such as residential, logistics, and hotels. Considering the overall diversity of REITs types in the US, the JREIT market has a great opportunity to grow and expand over the next decade.

<sup>22</sup> David Geltner & Norman G. Miller. "Commercial Real Estate Analysis and Investments." South-Western Publishing, 2001.

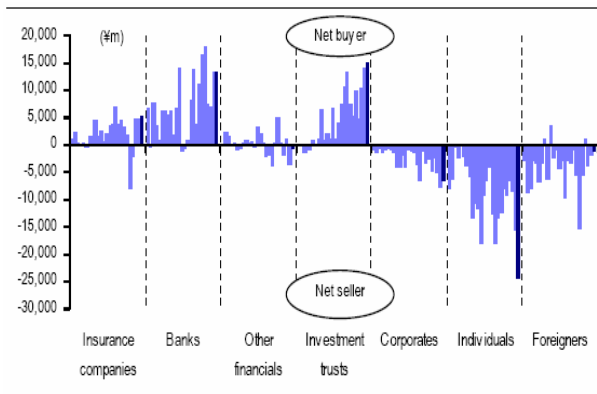
## JREIT COMPOSITION BY INVESTOR TYPE



Who the investors are and what their investment criteria are is the primary drivers of the current condition of the JREIT market pricing. Much can be explained when realizing that the individual investors hold only 20% (plus or minus) of the ownership in the JREIT.

The Japanese Institutional Investor's investment criteria are in many cases much different than the private individual. Moreover, the keiretsu concept is appearing again through the ownership of the JREIT units, in that 80% (plus or minus) of the shares are held by financial institutions and domestic firms who have or are trying to achieve a general relationship of some kind with the parent company and operator. While many of these 'relationships' are not historically established, through the JREIT investors are able to achieve some ownership of the real estate as well as the operating firm.

Moreover, the pricing of a single unit of JREIT stock ranges from 399k to 1.02MM JPY, or approximately 3,900 to 10,000 USD; very high for an average professional to participate in ownership; another reason for the heavily institutional ownership presence.



JREIT Investment Trend by Investor Category

SOURCE: Tokyo Stock Exchange

It's critical to understand who the buyers of the JREITs are and it's not individuals or private investors, it is regional banks, investment institutions, and insurance companies who are buying.

Hence, while much suggests overpricing, the primary investors are getting a yield over 3%, which provides enough spread over the JGBs to be attractive to investors.



## ANALYSIS CONCLUSION

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Are the JREITs overpriced? Is the race to securitize real estate forming a mini-bubble? Is the JREIT a safe investment for the average investor, or is this just a way for real estate firms to pass off risk to investors?

In Japan, the value of real estate was thought to never decrease and would continue to rise endlessly. As a natural result, real estate has always been considered a prized value source and a symbol of wealth and success. However since the bubble burst and market crash of the early 90s many large institutions and people were burned and the image of real estate has since suffered. After more than a decade, times may be changing.

The average investor's access to real estate has historically been virtually impossible and dominated by large corporate conglomerates that traded real estate among subsidiaries or closely related firms. The economic downturn has forced a change in this long standing tradition.

Real estate securitization is a relatively new concept in Japan. A new fervor has begun and the real estate investment market has been on fire with tremendous demand from domestic and even foreign investors. Over the past eight years, particularly since 2003, real estate securitization has become one of the most dynamic fast paced growth industries; exploding from 61.6B JPY in 1997 to over 7,518B JPY in 2005.

In September 2001, the Japanese real estate industry marked a new era in public real estate investments by issuing the first JREIT. Since then, another 16 JREITs have been issued and market capitalization has grown from 260MM JPY to an estimated 2,213MM JPY in four years.

Interestingly enough, during this time the general health of Japanese real estate has been mediocre at best. Even with land prices on the decline, vacancy rates on the rise, and rental rates deflating; the investment market is heating up and cap rates are falling. This is cause for some concern, in that only 19% of the Tokyo market is made up of Class-A assets (considerably more stable in cash flow generation and value retention). These falling cap rates seem to be dropping without any regard to individual assets or property risks; as the competition increases investors are forced to acquire less than high quality assets, generating low returns for non-superior properties in secondary markets (cap rates have fallen 1.6% in these weaker areas); is this a mini-bubble or an expansion of the definition or criteria that categorizes institutional quality real estate? It's difficult to know what the answer is and only time will tell, but regardless it would seem that investor risk is on the rise and the economy will not likely rebound at a rate fast enough to feed this pressure.

While the public nature and disclosure requirements of the JREIT keep those involved under tremendous scrutiny from the public and analysts, the JREITs are flying high on this investment rocket where some have more than doubled in stock value over the past few years, with the average having grown over 50%. Yields on these JREITs have all fallen down to the 3% range. Yet, earnings per share are projected to fall for most of the JREITs in the coming fiscal period. Nevertheless, a 3% yield is generating a significant yield spread of the very low long-term government bonds.

As may be the case with any new product type, the general investor shows little foresight and understanding of how to best judge real risk exposure and as a result all JREITs have been considered 'good,' regardless of the generally accepted valuation determinants; such as P/NAV (PBR), asset mix, regional diversification, leverage levels, and management capabilities. The opportunity to invest in real estate and take part in this new type of investment product has been extremely popular among investors,

both institutional and non-institutional. This herd movement is arguably more common in Japan, where the group mentality is deeply rooted in the culture.

However, this may be short-lived, as more JREITs enter the market and competition grows, the differences among the JREITs will become more evident as public expectations intensify. These expectations will likely be based on the effectiveness and ability of the operating firm "...even buildings that are subject to these conditions [market correction] with regard to their sizes, facilities and locations will have less risk of cancellations and rent reductions if they are under appropriate administration and management. In fact, if property managers and JREITs which administer and manage buildings are able to demonstrate resistance in the midst of a faltering market, this can become a unique opportunity to gain the confidence of investors..."<sup>23</sup> and further distinguish themselves among the pool of JREIT investment options.

This change in market attitude may already be underway. The two new JREITs that were issued this month, July 2005, were the first to not be received positively to the market. Prospect Residential Investment Corp (8969, issued on 7/12/2005) is a residential specialist; dropped sharply on its first trading day and has yet to hold any kind of growth. In addition, Japan Single-residence Reit Inc (8970, issued on 7/13/2005) also a residential specialist; followed a similar pattern and is trading at below IPO price. While this may just be a coincidence it was an opinion of one of the interviewees who participated in this paper, that the fact that both these JREITs are not performing very well may indicate that the JREIT investor may now realize that not all JREITs are created equal.

The different risk exposure among the JREIT may not be truly known for some time, but it would seem through this analysis that indeed not all the JREITs are created equal. Clearly, the public valuation (P/NAV) of some of the JREITs is too high, and some are exposed to more volatile real estate products in weaker regions. Yet the macro economic conditions, particularly the volatility of the stock market, limited investment alternatives, and the yield spread over JGBs suggests that the JREITs should be somewhat inflated as they are an attractive investment, with regard to risk and return.

The next several years will be a critical time for the entire Japanese economy including the real estate industry. As the population begins to decline and demand for real estate drops, pressure will increase on owners and operators. In the end, the homogeneous performance characteristics of the JREITs will not hold, and a wider range of yields that more accurately reflect the risk profiles among the JREITs will take hold. Furthermore, if the economy improves and interest rates are raised, further real estate price corrections will surely follow, and those JREITs that have issued at much lower yield levels will be forced to further invest in less quality assets and in less than ideal areas in order to improve their yields, further increasing the funds real estate risk.

Nevertheless, the JREIT has been a positive force in the Japanese real estate industry. In a country where business transparency has never been very high, especially in the real estate market, the public nature of the JREIT is improving the transparency and helping to revive the industry. In addition, it is also providing portfolio managers and individual investors the option of adding real estate to diversify their investments and improve their overall risk-adjusted returns and reduce volatility.

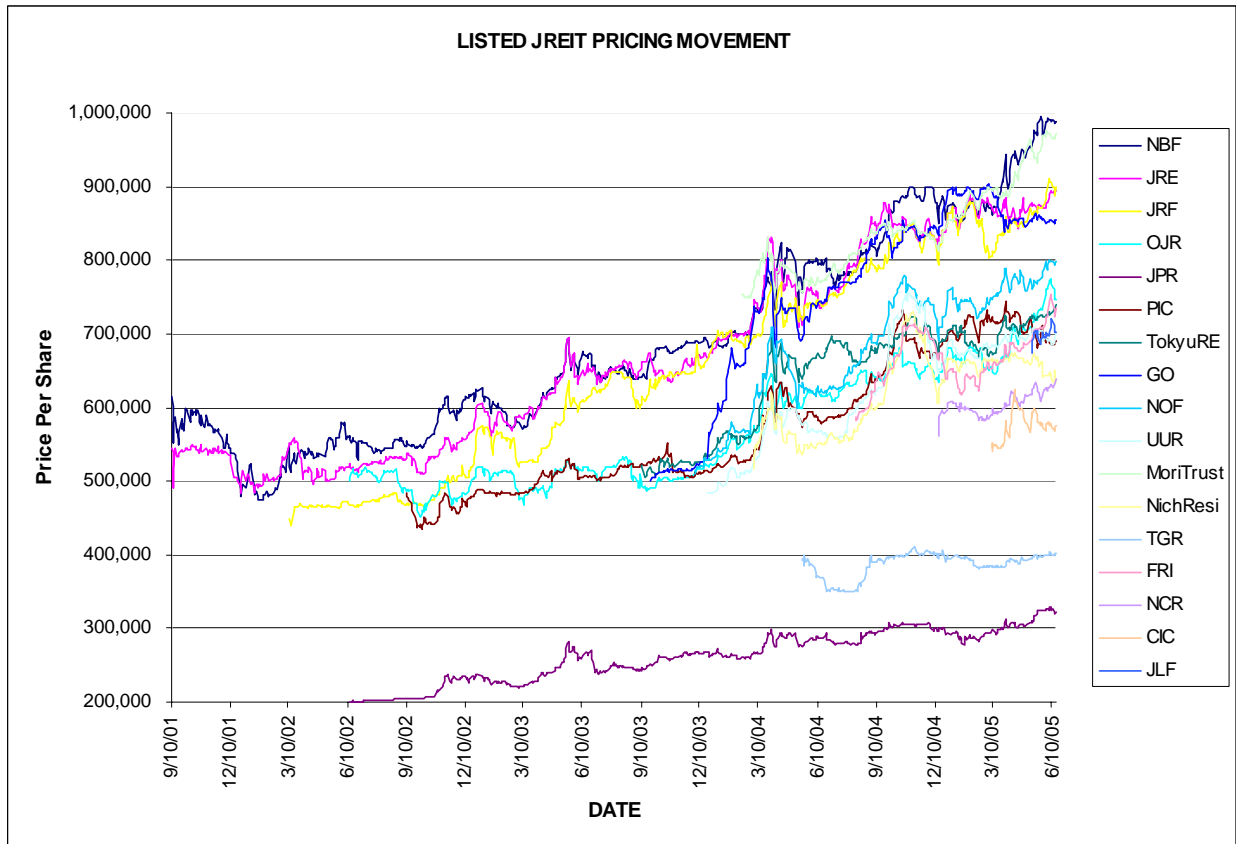
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<sup>23</sup> NLI Research Institute. "Tokyo Office Market's "2010 Problem." Attractors Lab Co., Ltd. 2002

## CURRENT LISTED JREITs

The following section provides a summary of the currently listed JREITs. While the summaries are limited and in no way a complete picture of each JREIT they are meant to provide some elaboration on important characteristics of the organization and operations. Key points were considered the investment strategy, vertical integration, and investor profile. In addition, pictorial and graphical summaries of stock price movement, product and regional diversification, as well as leverage and capital highlights.

The JREITs are listed in order of time of issue on the market.



Market Capitalization grew from 260MM JPY with the first two JREITs in September 2001 to the now (as of 6/17/2005) estimated at 2,213MM JPY, a change of 751% over the past four years. Price per share has more than doubled for some of the JREITs and most have appreciated over 50% since the time of issue, with the overall market moving in an appreciative motion.

## Nippon Building Fund, Inc. (NBF)

<b>Name</b>	<b>Nippon Building Fund, Inc. (NBF)</b>
<b>Ticker</b>	8951
<b>Detail</b>	Office Building Management
<b>Address</b>	2-7-2 Yaesu, Chuo-ku
<b>Operating Company</b>	Nippon Building Fund Management Ltd.
<b>Listed Date</b>	September 10, 2001
<b>Primary Shareholders of Operating Company</b>	Mitsui Fudosan Co., Ltd. (43%) Sumitomo Life Insurance Company (35%)
<b>No. of Properties</b> (as of 5/1/2005)	43
<b>No. of Tenants</b> (as of 5/1/2005)	667

### INVESTMENT STRATEGY

Nippon Building Fund Inc. was the first JREIT issued on the Tokyo Stock Exchange in September 2001. Headquartered in Tokyo, NBF has the largest total market capitalization of all the JREITs and the largest scale of managed assets. NBF is well positioned in the market with its strategic partnership with Mitsui Real Estate Co. Ltd., one of Japan's dominant real estate firms. NBF specializes in investing in office buildings. Currently it owns 43 properties with a focus on large-scale office buildings in the Tokyo central business districts, with diversified assets in regional cities as well. The 43 buildings total approximately 460,000 square meters of rentable space and occupied by approximately 667 tenants. NBF's primary investment objective is to achieve sustainable growth in portfolio value and stable profits on a mid-term to long-term basis. NBF achieves this objective by investing in real estate consisting of buildings primarily used for offices with their underlying land located in the Tokyo Central Business Districts, Other Greater Tokyo and Other Cities in Japan as well as securities, beneficiary certificates representing beneficial interests in trusts and other assets backed by office properties<sup>24</sup>.

### VIRTUAL INTEGRATION

NBF's operator Nippon Building Fund Management Ltd. was established in September 2000 and currently employs 14 real estate professionals. The most reputable professionals in the group were seconded from the top primary shareholders, Mitsui Fudosan Co., Ltd. and Sumitomo Life Insurance Company.

### INVESTOR PROFILE

61% of total stock ownership is held by financial or securities institutions; Mitsui Fudosan Co., Ltd (5%), Sumitomo Life Insurance Company (3.08%), The Nomura Securities Co., Ltd. (3.11%), and other well known institutions. Other legal entities hold approximately 14%, overseas investors hold 10.7%, and individuals and others hold approximate 13.5% of the stocks.

### STOCK/YIELD/EARNINGS (in JPY)<sup>25</sup>

<b>Total Invested Capital</b> (as of 6/21/2005)	430,378,000,000
<b>Equity</b>	216,985,000,000
<b>Debt</b>	213,393,000,000

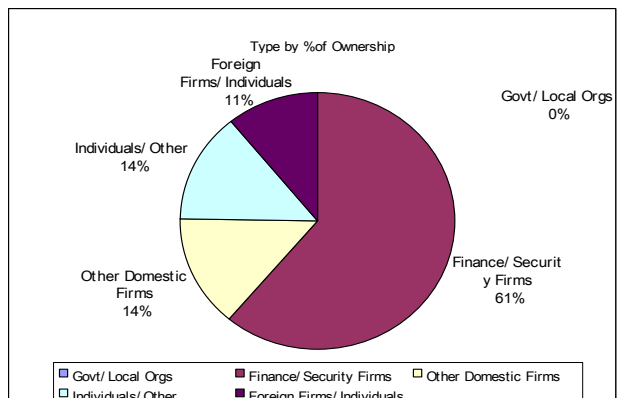
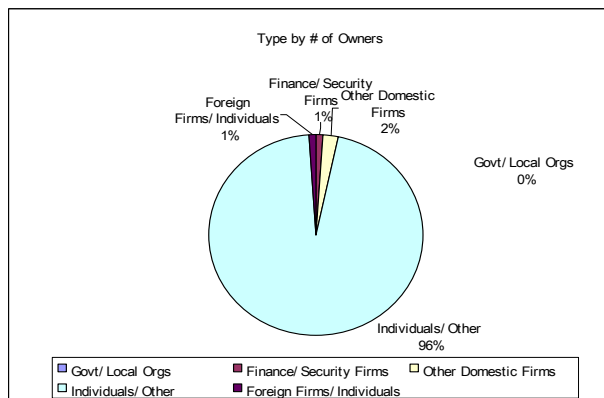
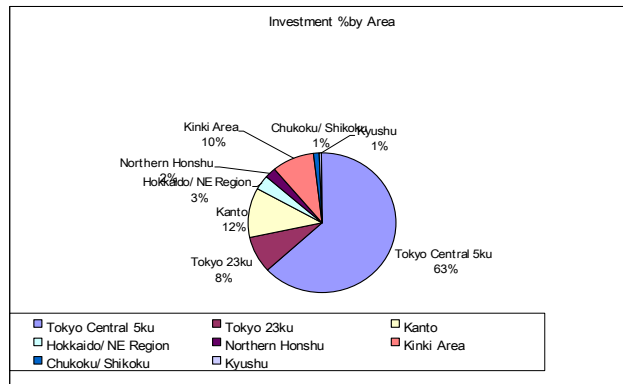
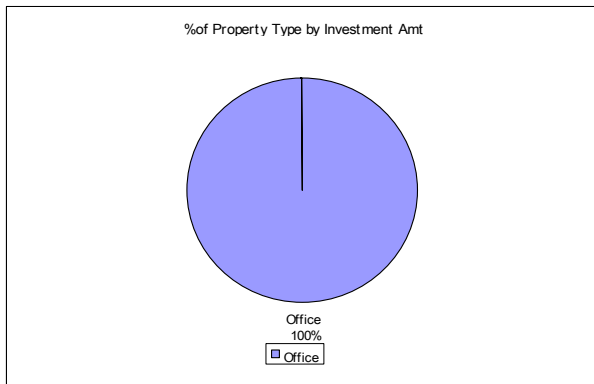
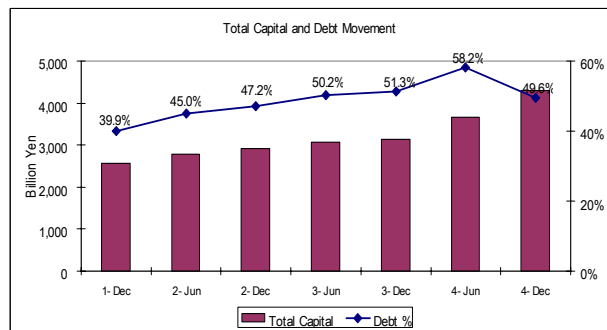
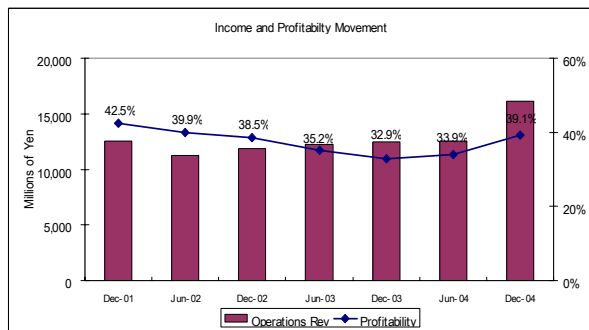
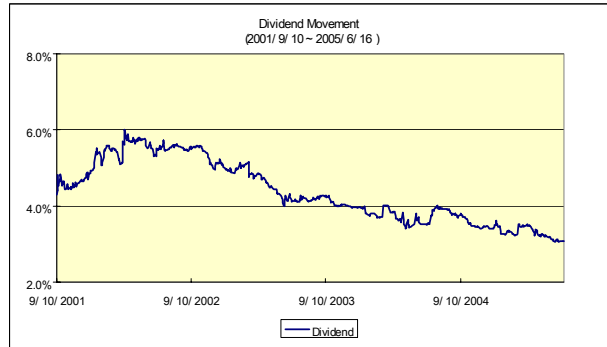
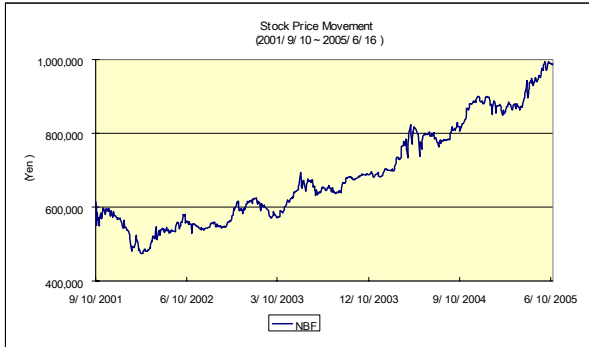
<b>No. Shares Outstanding</b>	364,700
<b>Price Per Share</b> (as of 6/29/2005)	999,000
<b>Market Capitalization</b>	364,335,000,000

<b>P/NAV</b>	1.679
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<sup>24</sup> [www.nbf-m.com](http://www.nbf-m.com)

<sup>25</sup> <http://www.ares.or.jp>

# Nippon Building Fund, Inc. (NBF)



## Japan Real Estate Investment (JRE)

<b>Name</b>	<b>Japan Real Estate Investment (JRE)</b>
<b>Ticker</b>	8952
<b>Detail</b>	Office Building Management
<b>Address</b>	3-3-1 Marunouchi, Chiyoda-ku
<b>Operating Company</b>	Japan Real Estate Asset Management Co., Ltdl
<b>Listed Date</b>	September 10, 2001
<b>Primary Shareholders of Operating Company</b>	Mitsubishi Estate Co., Ltd. (36%) Tokyo M&F Inc. (27%) The Dai-Ichi Mutual Life Insurance (27%) Mitsui & Co., Ltd. (10%)
<b>No. of Properties</b> (as of 5/1/2005)	39
<b>No. of Tenants</b> (as of 5/1/2005)	466

### INVESTMENT STRATEGY

Japan Real Estate Investment (JRE) was the second JREIT issued on the Tokyo Stock Exchange in September 2001. The firm holds the highest credit rating of any REIT; A+ from Standard & Poor's and A1 from Moody's Investor Service. The Company invests primarily in specified assets, consisting of real estate assets and real estate related securities with the goals of achieving stable growth in value over a medium- to long-term period. Currently the company has invested in 39 office properties with 66% located in Tokyo's central 5-ku and the remaining spread across northern and southern Japan.

### VERTICAL INTEGRATION

Japan Real Estate Investment Corporation, headquartered in Tokyo, Japan, is a real estate investment consultancy based in Japan, providing real estate consulting services through its expertise in real estate appraisal, financial planning, tax accounting, construction, legal documents and legal advice. The Company's service covers four major areas: selection, management and trading of portfolios; real estate investment advice; researching of portfolios and investigation and research of the real estate market and investment. JRE holds a strong collaboration with Mitsubishi Estate Co., Ltd., Tokyo Marine and Fire Insurance Co., Ltd., and Mitsui and Co., all well known firms in Japan.

### INVESTOR PROFILE

65% of total stock is held by financial or securities institutions; Mitsubishi Estate Co., Ltd. (3.9%), Tokio Marine & Fire Insurance Co., Ltd. (3.12%), State Street Bank and Trust Company (3.32%), and other regional institutions.

### STOCK/YIELD/EARNINGS (in JPY) <sup>26</sup>

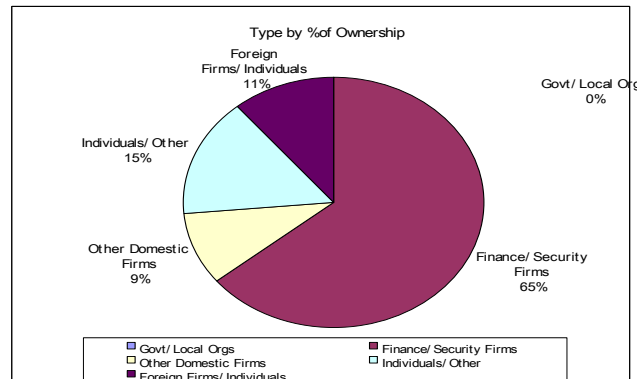
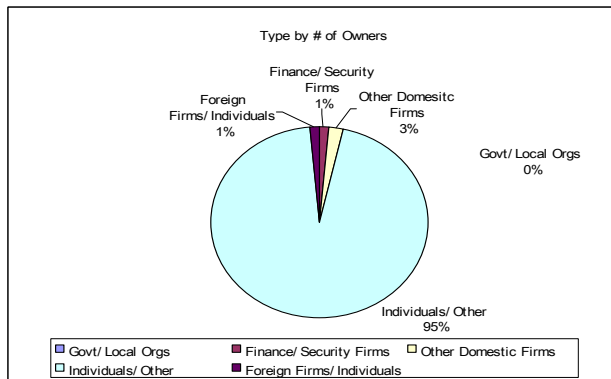
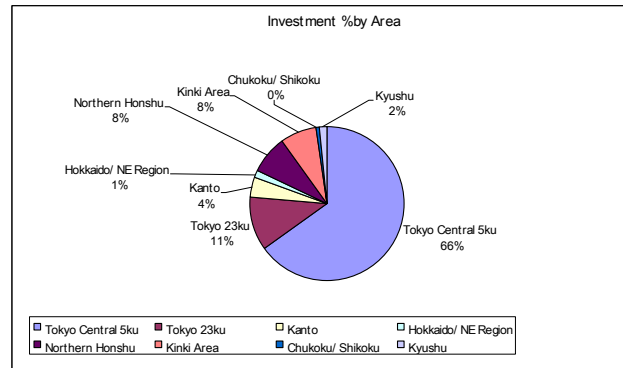
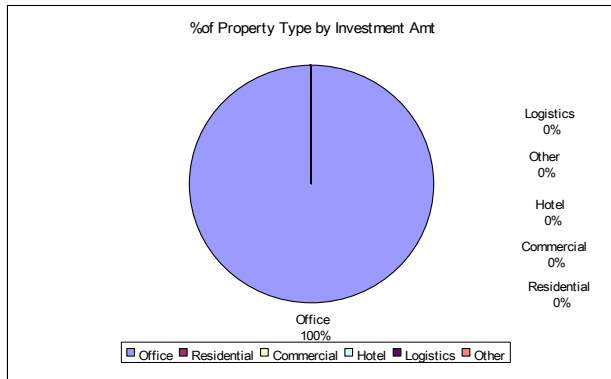
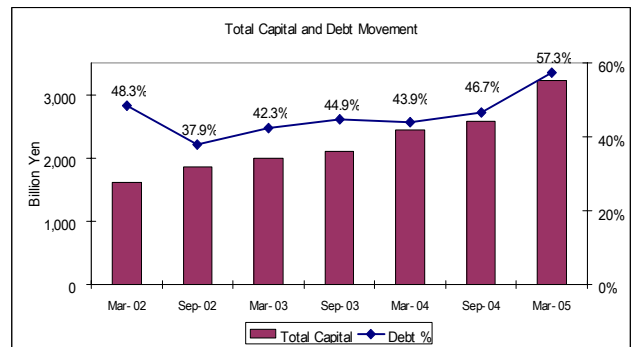
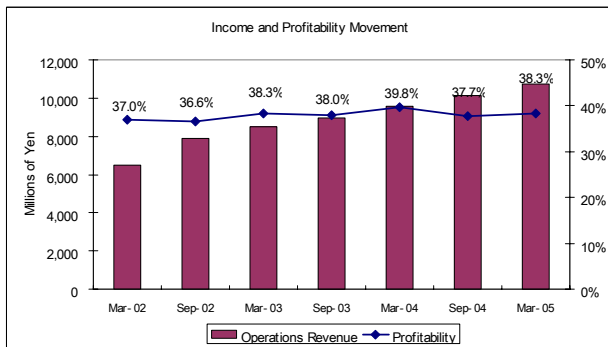
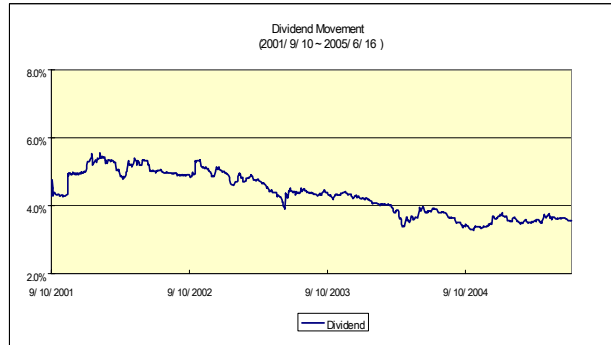
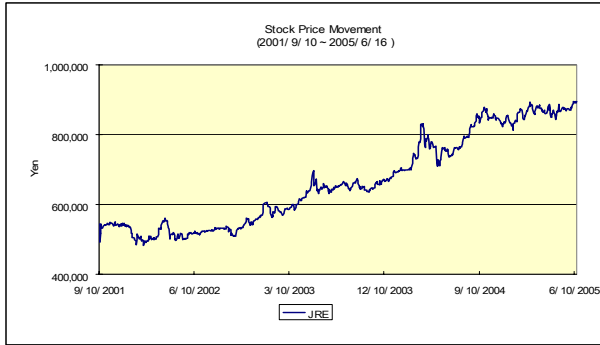
<b>Total Invested Capital</b> (as of 6/21/2005)	322,358,000,000
<b>Equity</b>	137,569,000,000
<b>Debt</b>	184,789,000,000

<b>No. Shares Outstanding</b>	345,400
<b>Price Per Share</b> (as of 6/29/2005)	939,000
<b>Market Capitalization</b>	324,330,600,000

<b>P/NAV</b>	2.358
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<sup>26</sup> <http://www.ares.or.jp>

# Japan Real Estate Investment (JRE)



## Japan Retail Fund Investment (JRF)

<b>Name</b>	<b>Japan Retail Fund Investment (JRF)</b>
<b>Ticker</b>	8953
<b>Detail</b>	Commercial Facility Management
<b>Address</b>	4-3 Kioicho, Chiyoda-ku
<b>Operating Company</b>	Mitsubishi Corp – UBS Realty Inc.
<b>Listed Date</b>	March 12, 2002
<b>Primary Shareholders of Operating Company</b>	Mitsubishi Corporation USB AG
<b>No. of Properties</b> (as of 5/1/2005)	24
<b>No. of Tenants</b> (as of 5/1/2005)	305

Japan Retail Fund Investment Corporation (the Trust) is a Japanese real estate investment trust (REIT) that focuses exclusively on the retail property sector. The Trust owns 21 retail properties, containing approximately 840,000 square meters of leasable space, with a weighted average building age of 9.6 years. Its investment objective is to secure relatively stable distributions for unit holders and steady increases in the value of its property portfolio, in the medium to long term. However, only 11% of the portfolio is located in Tokyo's Central 5-ku, with the majority in the outer Tokyo areas (37%).

### INVESTMENT STRATEGY

JRF focuses exclusively on the retail property class. The investment objective is to secure ownership in the medium to long term, relatively stable distributions for our shareholders and steady increases in the value of the property portfolio. "We seek to continue to acquire income-type retail properties, featuring long-term, anchor tenant leases with fixed rents, in order to produce relatively stable cash flow. We also seek to acquire growth-type retail properties which can offer potential growth in property value and cash flow by linking portions of our rental revenues to the business performance of certain tenants, with fixed minimum rents or scheduled minimum rent increases, as well as through active property management to improve tenant quality and occupancy rates. We will seek to diversify the geographic locations of our properties to minimize region-specific economic and seismic risks."<sup>27</sup>

### VIRTUAL INTEGRATION

JRF entered into an asset management agreement with Mitsubishi Corp.-UBS Realty Inc. in September 2001. The Asset Manager is the first cross-border J-REIT asset management company, owned 51% by Mitsubishi Corporation and 49% by UBS AG.

### INVESTOR PROFILE

Some notable top shareholders include Mitsubishi Corporation (6.3%), Goldman Sachs International Ltd. (1.8%), and five regional banks from southern Japan; Individuals hold approximately 14% of ownership.

### STOCK/YIELD/EARNINGS (in JPY)<sup>28</sup>

<b>Total Invested Capital</b> (as of 6/21/2005)	244,706,000,000
<b>Equity</b>	119,573,000,000
<b>Debt</b>	125,133,000,000

<b>No. Shares Outstanding</b>	279,502
<b>Price Per Share</b> (as of 6/29/2005)	954,000
<b>Market Capitalization</b>	266,644,908,000

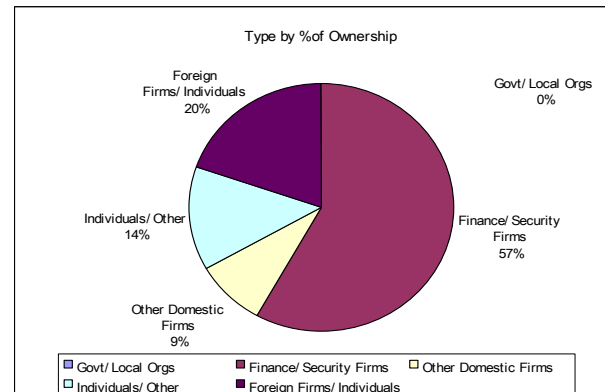
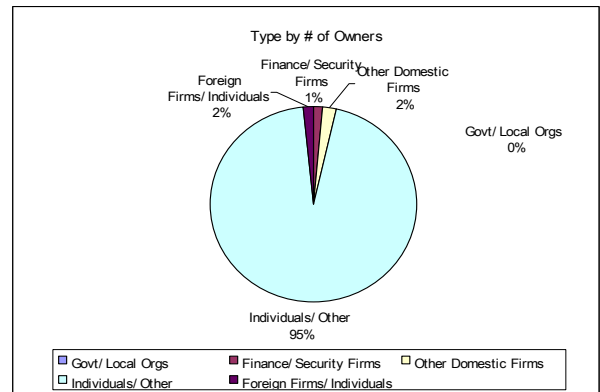
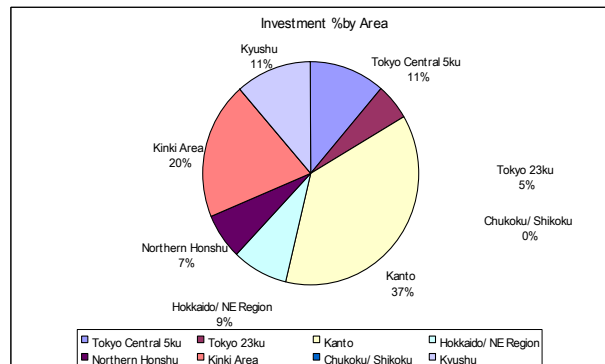
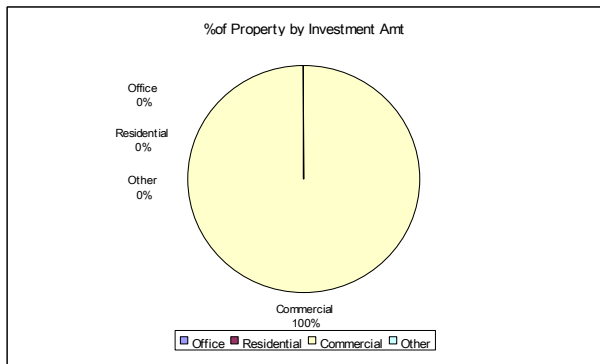
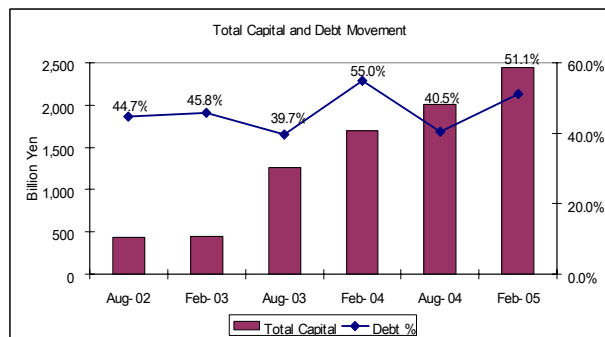
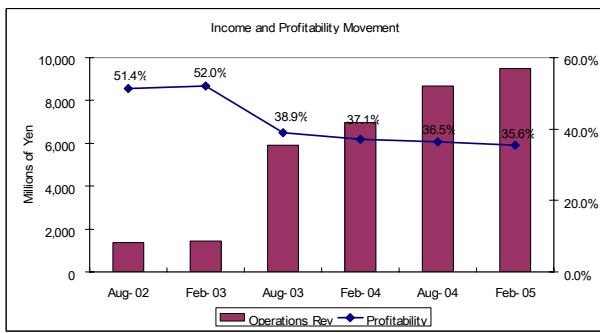
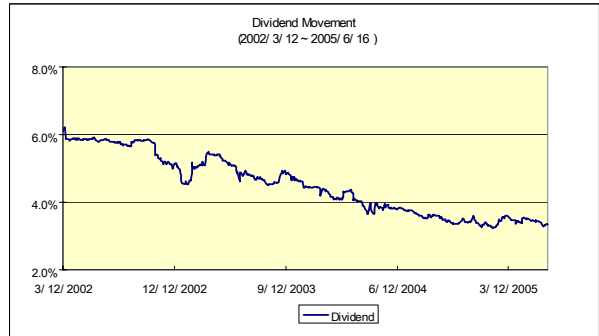
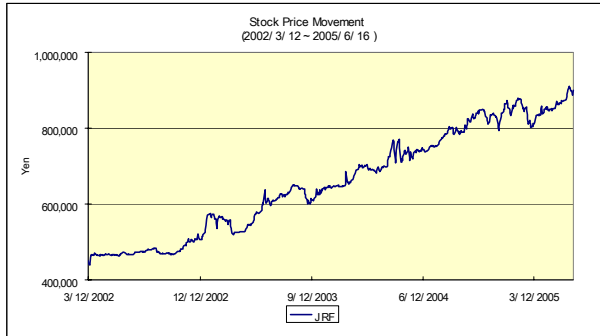
<b>P/NAV</b>	2.230
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<sup>27</sup> [www.jrf-reit.com](http://www.jrf-reit.com)

<sup>28</sup> <http://www.ares.or.jp>



# Japan Retail Fund Investment (JRF)



## Orix JREIT Inc. (OJR)

<b>Name</b>	<b>ORIX JREIT Inc. (OJR)</b>
<b>Ticker</b>	8954
<b>Detail</b>	Focused on Tokyo Metropolitan Area
<b>Address</b>	2-4-1 Hamamatsucho, Minato-ku
<b>Operating Company</b>	ORIX Asset Management Corporation
<b>Listed Date</b>	June 12, 2002
<b>Primary Shareholders of Operating Company</b>	Orix Corporation (100%)
<b>No. of Properties</b> (as of 5/1/2005)	46
<b>No. of Tenants</b> (as of 5/1/2005)	264

### INVESTMENT STRATEGY

ORIX JREIT Inc. (OJR) was listed on the Tokyo Stock Exchange in June 2002 as the fourth JREIT. OJR is one of the largest diversified type JREITs that invests in quality office, residential, retail and hotel properties, aiming to provide stable cash flows and healthy asset growth over the medium to long term. Currently OJR owns some 46 properties, occupied by 264 tenants. OJR's investment policy includes the following three critical strategies, 1) Office-oriented diversified portfolio (office properties (83%), hotel properties (10%), retail properties (4%) and residential properties (3%), 2) Focus on Tokyo Metropolitan Area (63% of assets are in Tokyo 5ku and 81% are located in Tokyo 23ku, 3) Target Medium-sized assets (focusing on acquiring medium-sized properties with total floor area from 3,000 to 10,000 square meters; Due to its strategic relationship with the ORIX Group, which is a strong medium-sized office property developer.

### VERTICAL INTEGRATION

OJR is managed by ORIX Asset Management. ORIX Asset Management was incorporated in September 2000 and is a wholly-owned subsidiary of ORIX Corporation. It has no 3<sup>rd</sup> party investors involved in the ownership of the operating firm.

### INVESTOR PROFILE

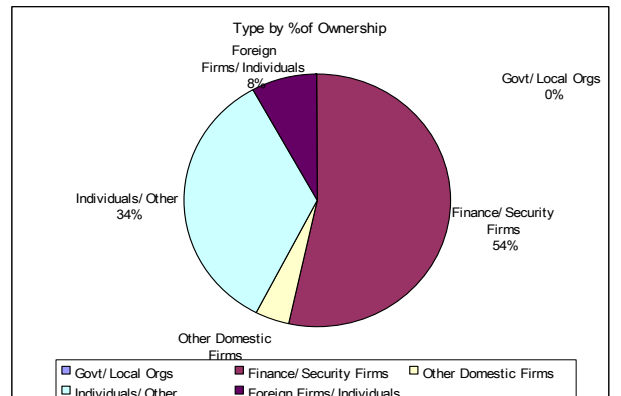
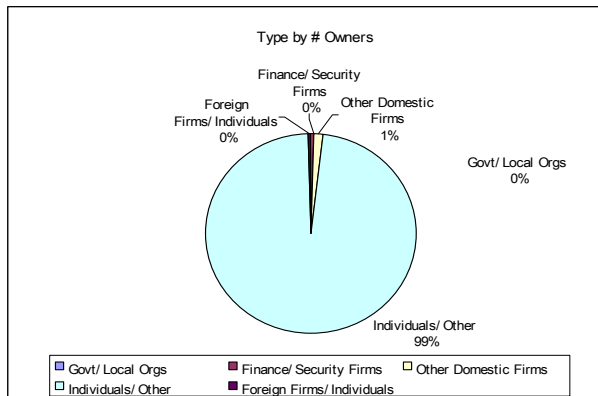
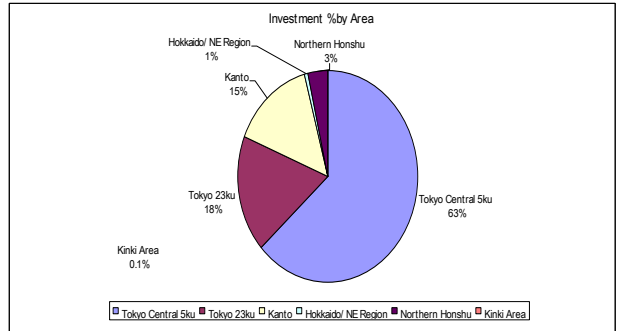
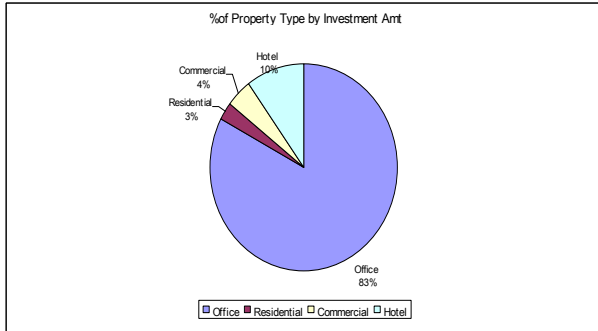
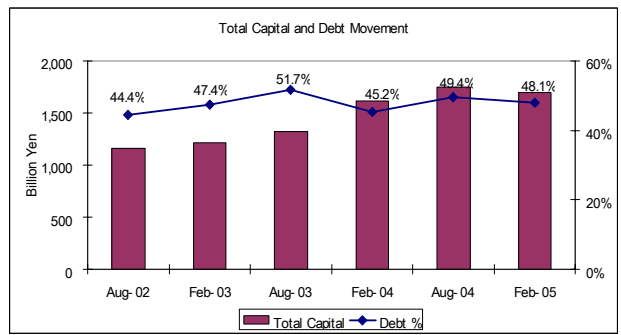
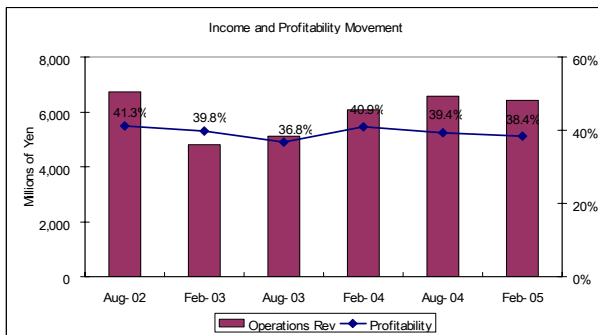
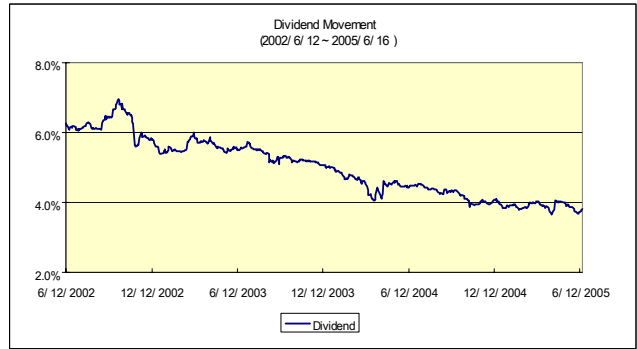
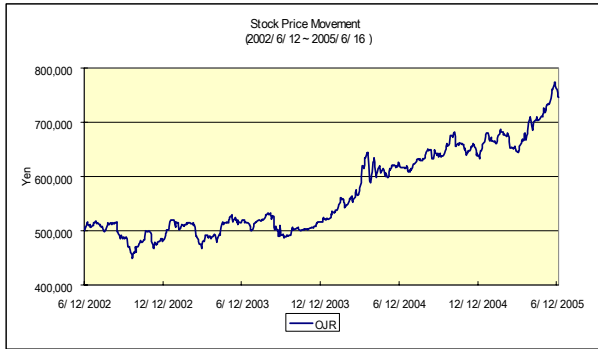
54% of the issued shares outstanding are held by financial institutions and security firms. Another 34% is held by individuals and 8% by foreign firms. Major unit holders include ORIX Life Insurance Corporation (10.12%), Japan Trustee Services Bank (5.03%), and a group of domestic and foreign institutional investors.

### STOCK/YIELD/EARNINGS (in JPY) <sup>29</sup>

<b>Total Invested Capital</b> (as of 6/21/2005)	170,012,000,000
<b>Equity</b>	88,288,000,000
<b>Debt</b>	81,724,000,000
<b>No. Shares Outstanding</b>	175,372
<b>Price Per Share</b> (as of 6/29/2005)	792,000
<b>Market Capitalization</b>	138,894,624,000
<b>P/NAV</b>	1.573

<sup>29</sup> <http://www.ares.or.jp>

# Orix JREIT Inc. (OJR)



## Japan Prime Realty Investment (JPR)

<b>Name</b>	<b>Japan Prime Realty Investment (JPR)</b>
<b>Ticker</b>	8955
<b>Detail</b>	Nationally Distributed Properties (Office/Retail)
<b>Address</b>	1-9-9 Yaesu, Chuo-ku
<b>Operating Company</b>	Tokyo Realty Investment Management, Inc.
<b>Listed Date</b>	June 14, 2002
<b>Primary Shareholders of Operating Company</b>	Tokyo Tatemono Co., Ltd. (26%) Meiji Yasuda Life Insurance Company (24%) Taisei Corporation (20%) Yasuda Real Estate Co., Ltd. (20%)
<b>No. of Properties</b> (as of 5/1/2005)	42
<b>No. of Tenants</b> (as of 5/1/2005)	496

### INVESTMENT STRATEGY

Japan Prime Realty Investment Corp. (JPR) is a Japanese investment company that principally invests in real estate and real estate-related areas. It aims to achieve sustainable growth and stable cash distribution to investors, through investment in office buildings and retail properties located in Tokyo and other major cities, and focuses on the risk/return profile of the investments. The Company's basic investment strategy centers on "urban commercial real estate". The Company will invest primarily in real estate, which comprises superior office buildings (urban business facilities), retail facilities located in thriving commercial areas, and the land on which these facilities are located, as well as in asset-backed securities, which have such real estate as their primary investments.<sup>30</sup> JPR holds 78% and 22% of its investment portfolio in office and commercial buildings, respectively. With 41% located within Tokyo's central 5ku and 51% within the Tokyo 23, it is well diversified geographically across Japan.

### VIRTUAL INTEGRATION

Tokyo Realty Investment Management, Inc. ("TRIM") has full asset management responsibilities for JPR. It was founded in September 2001 and is held in primary ownership, as detailed above, by Tokyo Tatemono Co., Ltd., and Meiji Yasuda Life Insurance Company.

### INVESTOR PROFILE

Approximately 2/3 of the major shareholders are financial and securities firms; Japan Trustee Services Bank, Ltd. (8.79%), Tokyo Tatemono Co., Ltd. (6.81%), Meiji Yasuda Life Insurance Company (5.58%), and other regional and international firms (AIG STAR LIFE INSURANCE CO., LTD (2.37%) and Goldman Sachs International (1.91%).

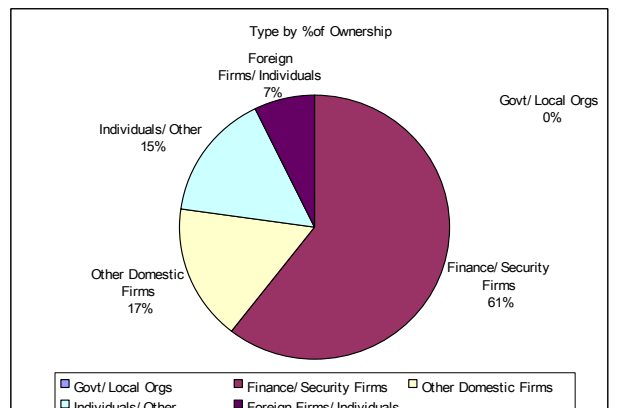
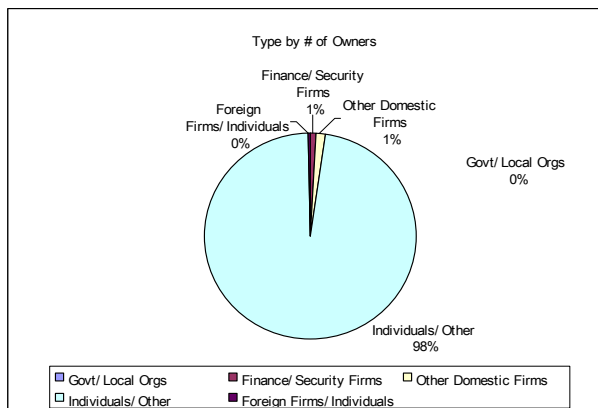
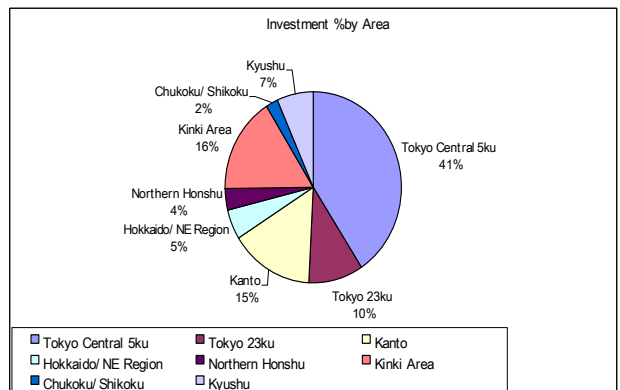
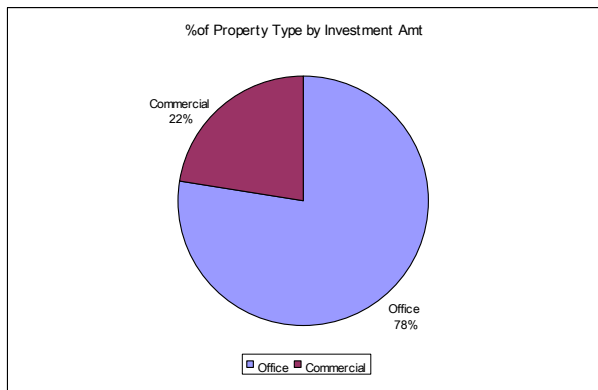
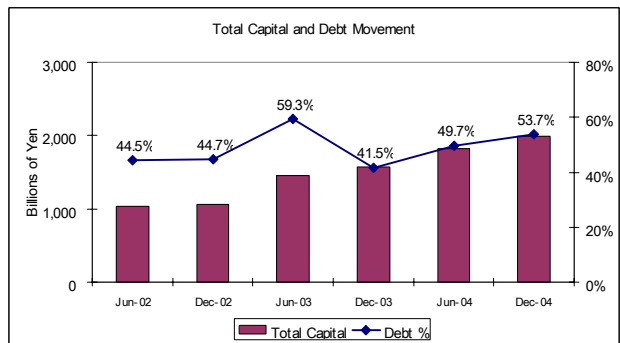
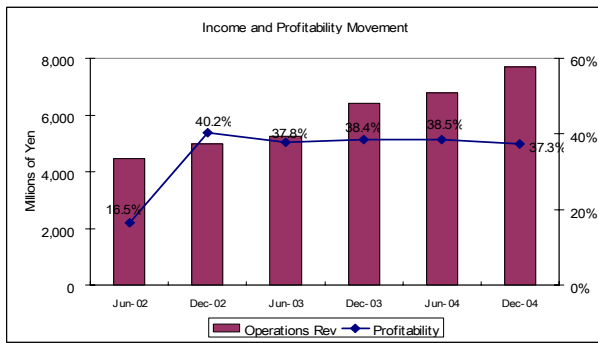
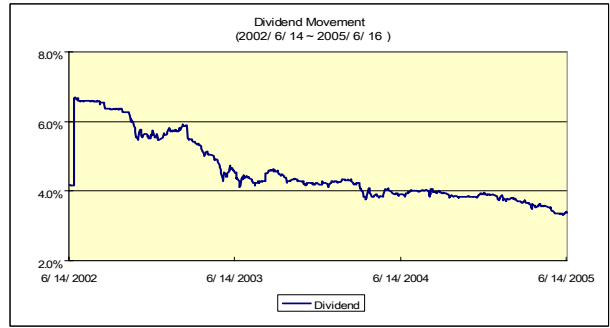
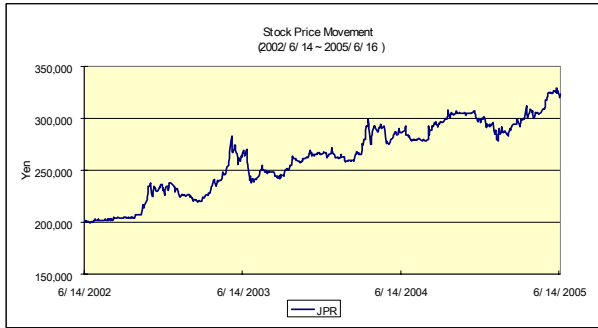
### STOCK/YIELD/EARNINGS (in JPY)<sup>31</sup>

<b>Total Invested Capital</b> (as of 6/21/2005)	198,673,000,000
<b>Equity</b>	91,982,000,000
<b>Debt</b>	106,691,000,000
<b>No. Shares Outstanding</b>	530,000
<b>Price Per Share</b> (as of 6/29/2005)	323,000
<b>Market Capitalization</b>	171,190,000,000
<b>P/NAV</b>	1.861

<sup>30</sup> [www.jpr-reit.co.jp](http://www.jpr-reit.co.jp)

<sup>31</sup> <http://www.ares.or.jp>

# Japan Prime Realty Investment (JPR)



## Premier Investment Corporation (PIC)

<b>Name</b>	<b>Premier Investment Corporation (PIC)</b>
<b>Ticker</b>	8956
<b>Detail</b>	Focused on Tokyo Metropolitan Area
<b>Address</b>	1-2-7 Azabu, Minato-ku
<b>Operating Company</b>	Premier REIT Advisors Co., Ltd.
<b>Listed Date</b>	September 2002
<b>Primary Shareholders of Operating Company</b>	Ken Corporation (27.1%) Nikko Building Co., Ltd. (18%) Chuo Mitsui Asset Management Co. (10%) Mitsui Sumitomo Insurance Co., Ltd. (10%)
<b>No. of Properties</b> (as of 5/1/2005)	23
<b>No. of Tenants</b> (as of 5/1/2005)	587

### INVESTMENT STRATEGY

Premier Investment Corporation is a Japan-based investment company that specializes in the Tokyo metropolitan economic block. The Company has multiple investment assets. It has made investments primarily in real estate properties used as offices (currently 58%) and residential (currently 42%) properties in the Tokyo metropolitan economic block, including Tokyo's five central wards (currently 81% of portfolio is located in the Central 5ku), characterized by a high concentration of population and industry, as well as established economic foundations. The company targets the following diversification ratios by area and use.

Use/Area	Tokyo 5ku	Tokyo 23ku (non-5ku)	Suburban Areas
Office	50% or more	0%-20%	0%-40%
Residential	50% or more	0%-40%	0%-20%

### VIRTUAL INTEGRATION

Premier REIT Advisors Co., Ltd. was established in July 2001 (primary funding provided by Ken Corporation Ltd., Mitsui Trust Financial Group, The Nikko Building Co., Ltd., and Mitsui Sumitomo Insurance Company, Limited) as detailed above.

### INVESTOR PROFILE

Major stockholders are diversified by 53% financial and security firms, with major shareholders as follows; Japan Trustee Services Bank, Ltd. (6.81%), The Master Trust Bank of Japan, Ltd. (3.76%), The Chuo Mitsui Trust Banking Company, Limited (3.74%), and a number of other regional banking and institutions.

### STOCK/YIELD/EARNINGS (in JPY)<sup>32</sup>

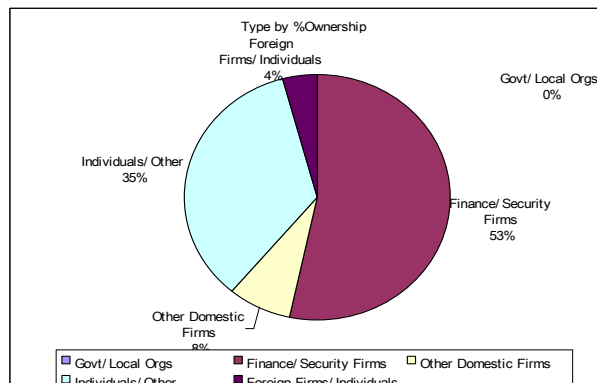
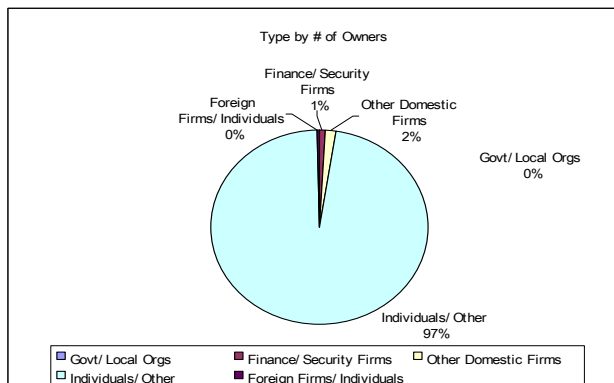
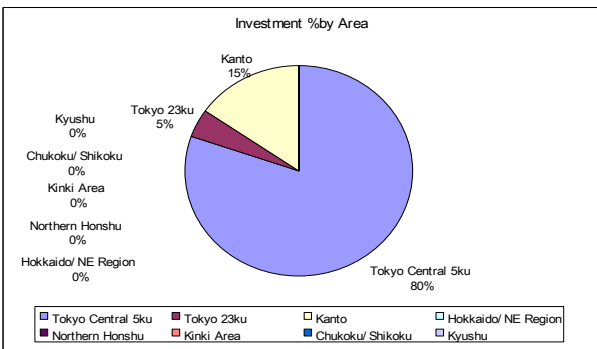
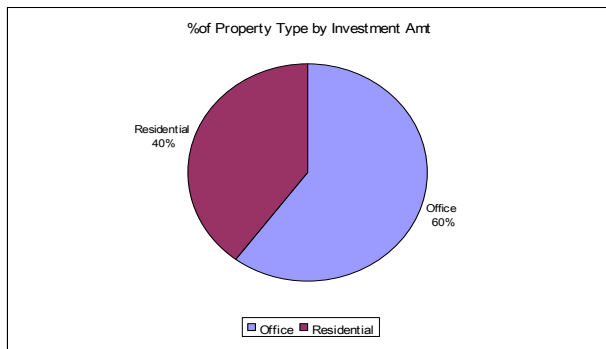
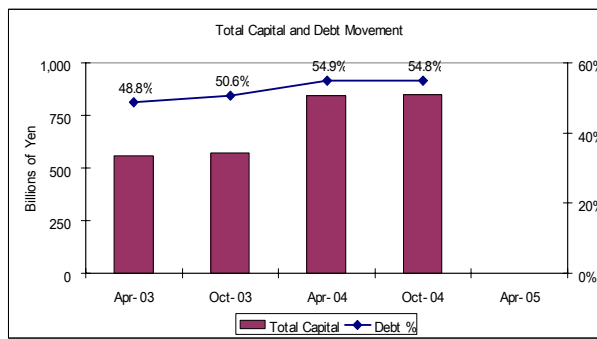
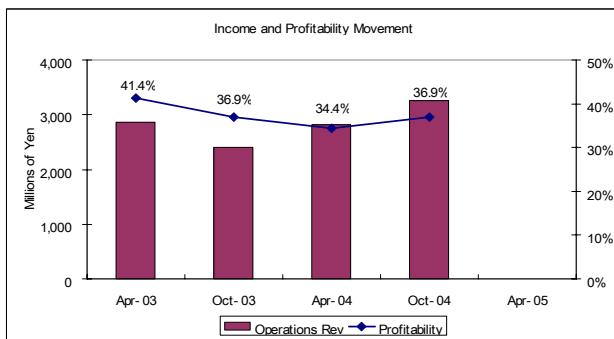
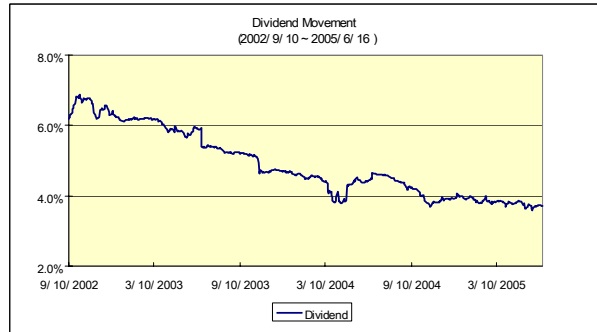
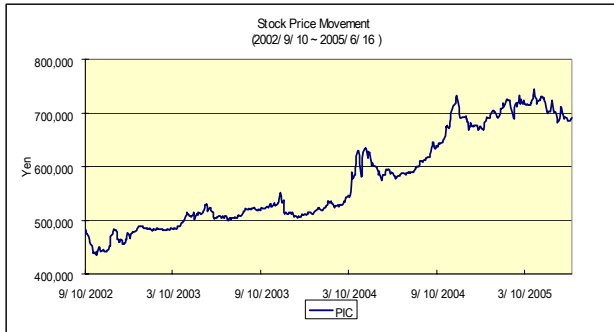
<b>Total Invested Capital</b> (as of 6/21/2005)	84,619,000,000
<b>Equity</b>	38,253,000,000
<b>Debt</b>	46,366,000,000

<b>No. Shares Outstanding</b>	79,400
<b>Price Per Share</b> (as of 6/29/2005)	710,000
<b>Market Capitalization</b>	56,374,000,000

<b>P/NAV</b>	1.473
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<sup>32</sup> <http://www.ares.or.jp>

# Premier Investment Corporation (PIC)



## Tokyu REIT, Inc. (TokyuRE)

<b>Name</b>	<b>TOKYU REIT, Inc. (TokyuRE)</b>
<b>Ticker</b>	8957
<b>Detail</b>	Dedicated to Tokyo Metropolitan Area
<b>Address</b>	1-12-1 Dogenzaka, Shibuya-ku
<b>Operating Company</b>	Tokyu Real Estate Investment Management Inc.
<b>Listed Date</b>	September 10, 2003
<b>Primary Shareholders of Operating Company</b>	Tokyu Corporation (60%) Tokyu Land Corporation (40%)
<b>No. of Properties</b> (as of 5/1/2005)	16
<b>No. of Tenants</b> (as of 5/1/2005)	105

### INVESTMENT STRATEGY

TOKYU REIT concentrates on pursuing investments in Central Tokyo, the Tokyu Areas, and other commercial and business districts in the Tokyo metropolitan area, including Kanagawa, Saitama and Chiba prefectures. Its core strategy is to invest in retail and office properties in these areas. It is intended that investments in such areas will comprise 85% or more of total portfolio and the remaining part of its portfolio (up to 15%) to consist of properties in other commercial and business districts in the Tokyo metropolitan area, including Kanagawa, Saitama and Chiba prefectures. The REIT does not intend to invest in properties in any areas other than those described above.

### VERTICAL INTEGRATION

TOKYU REIT has entered into a memorandum relating to the purchase and sale of real estate with Tokyu Corporation, Tokyu Land Corporation and Tokyu REIM with respect to acquisitions and dispositions of properties. There are no restrictions on TOKYU REIT or Tokyu Group companies (including Tokyu Corporation, Tokyu Land Corporation and Tokyu REIM) regarding the purchase and sale of real estate. Tokyu Corporation and Tokyu Land Corporation serve as the property managers.

### INVESTOR PROFILE

While the operations of this REIT are controlled by sister-firms, the primary shareholders are more diverse. Over 50% is held by domestic securities firms and institutions with major holders as Japan Trustee Services Bank, Ltd. (8.6%), Tokyu Corporation (4.14%), AIG STAR LIFE INSURANCE CO., LTD (3.26%), and The Gibraltar Life Insurance Co., Ltd. (2.78%).

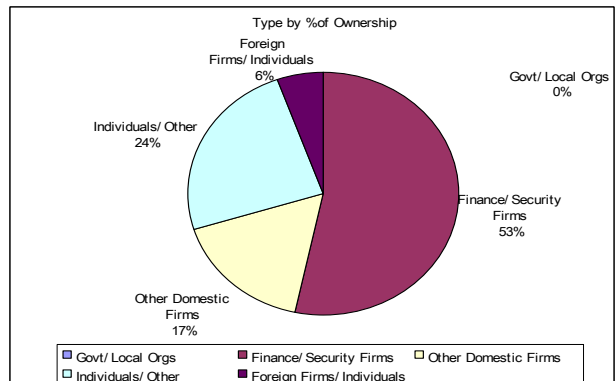
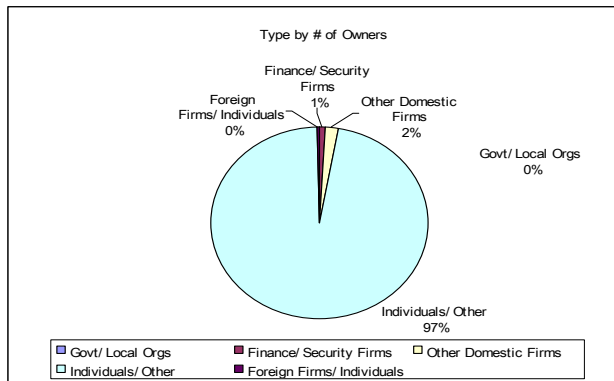
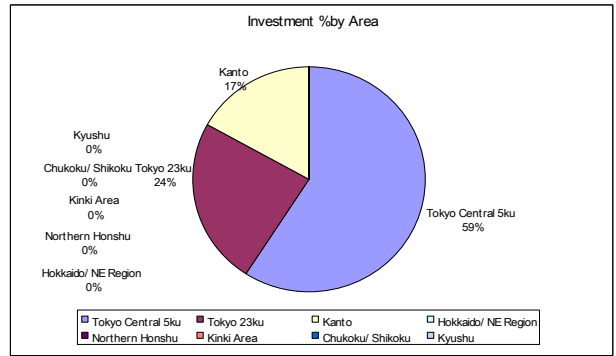
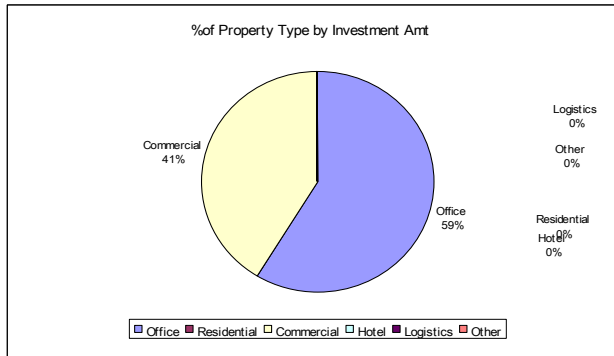
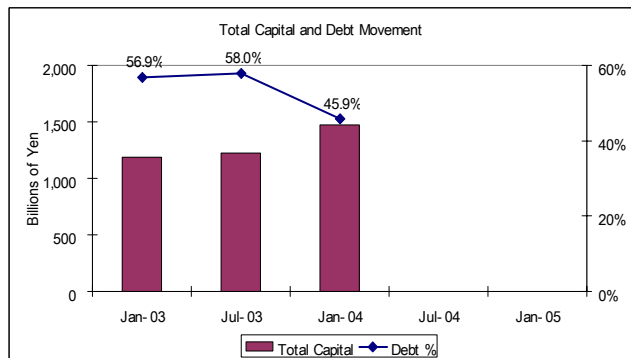
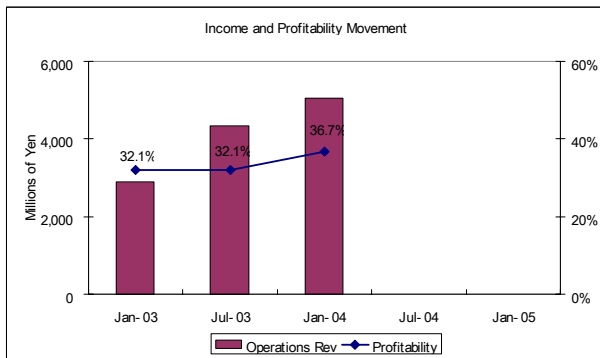
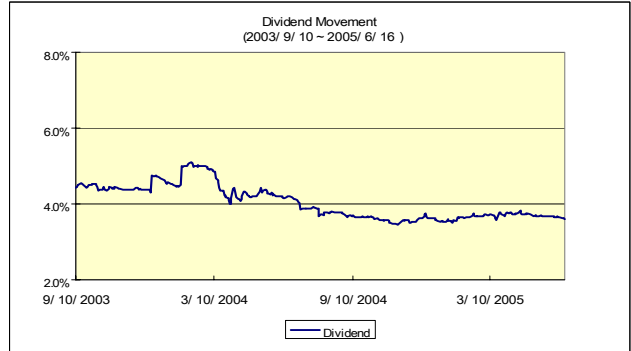
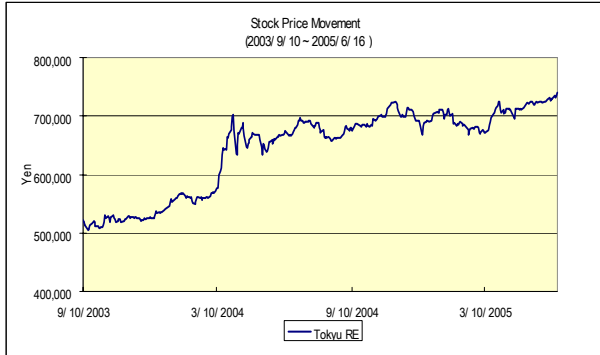
### STOCK/YIELD/EARNINGS (in JPY) <sup>33</sup>

<b>Total Invested Capital</b> (as of 6/21/2005)	147,230,000,000
<b>Equity</b>	79,712,000,000
<b>Debt</b>	67,518,000,000
<b>No. Shares Outstanding</b>	142,000
<b>Price Per Share</b> (as of 6/29/2005)	800,000
<b>Market Capitalization</b>	113,600,000,000
<b>P/NAV</b>	1.425

<sup>33</sup> <http://www.ares.or.jp>



# Tokyu REIT, Inc. (TokyuRE)



## Global One Real Estate Investment (GO)

<b>Name</b>	<b>Global One Real Estate Investment (GO)</b>
<b>Ticker</b>	8958
<b>Detail</b>	Office Building Management
<b>Address</b>	4-1 Kojimachi, Chiyoda-ku
<b>Operating Company</b>	Global Alliance Realty Co., Ltd.
<b>Listed Date</b>	September 25, 2003
<b>Primary Shareholders of Operating Company</b>	GMAC Commercial Mortgage Japan (14.9%) Kintetsu Corporation (10%) Meiji Yasuda Life Insurance Company (10%) Bank of Tokyo Mitsubishi (5%) Mitsubishi Trust and Banking Corporation (5%)
<b>No. of Properties</b> (as of 5/1/2005)	4
<b>No. of Tenants</b> (as of 5/1/2005)	66

### INVESTMENT STRATEGY

Global One Real Estate Investment Corp., headquartered in Tokyo, Japan, is a real estate investment company. The Company invests in real estate-related products, such as rights of real estate leasing, superficies, real estate investment trust, real estate-related securities and other real estate-related products. The Company's real estate properties include office buildings mainly in Tokyo and Aichi.

### VERTICAL INTEGRATION

Global Alliance is an 'independent' operating firm whose ownership is distributed among a number of major domestic institutions and a foreign mortgage firm. GMAC holds 14.9% stake in the operating firm, followed by Kintetsu Corporation and Meiji Yasuda Life Insurance Company with 10% each. The object of the ownership is to not have any single controlling entity that may cause conflicts of interest and truly be a 3<sup>rd</sup> party operator.

### INVESTOR PROFILE

63% of the outstanding shares are held by domestic financial and securities institutions, with another 6% from other domestic firms. 29% is held by individuals or the like with only 2% held by foreign firms.

### STOCK/YIELD/EARNINGS (in JPY) <sup>34</sup>

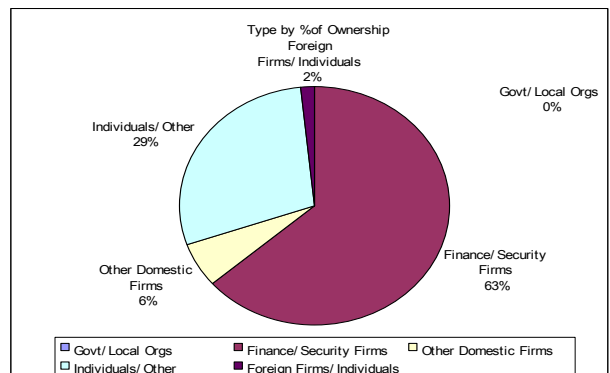
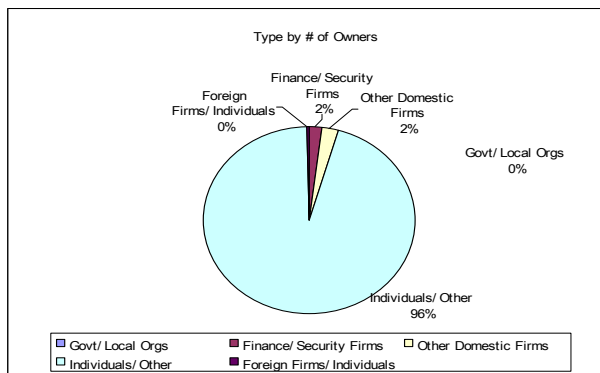
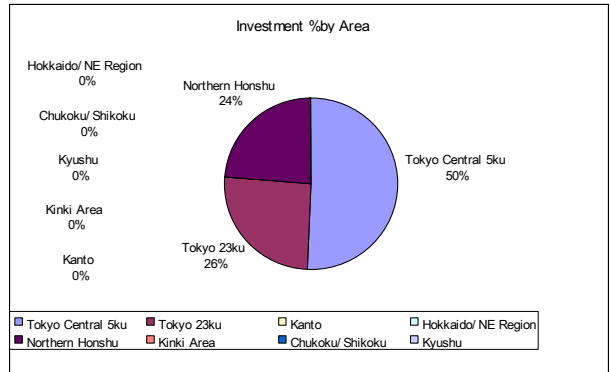
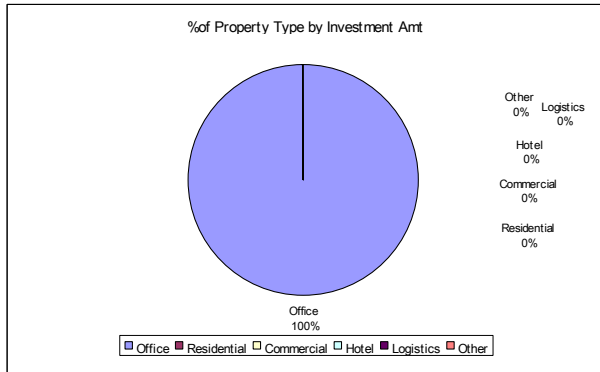
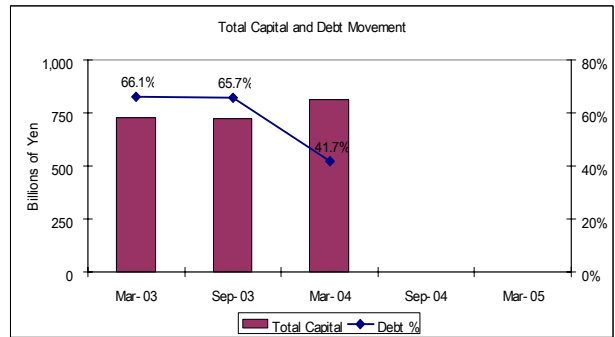
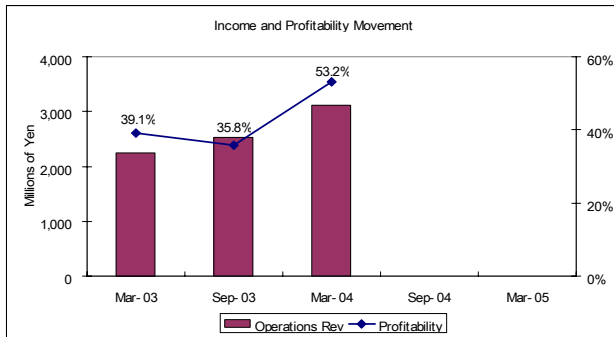
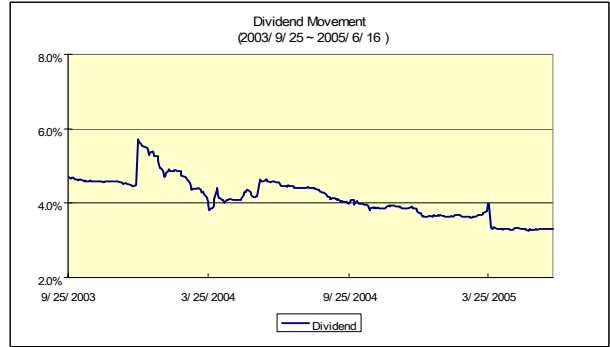
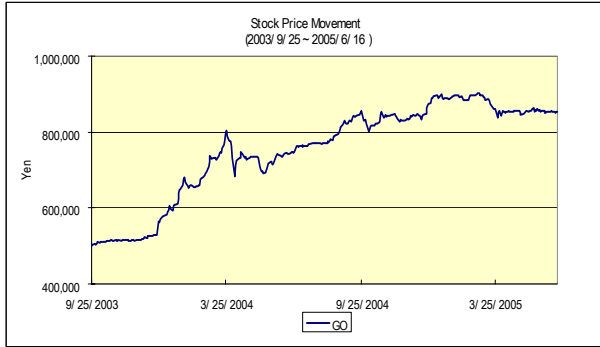
<b>Total Invested Capital</b> (as of 6/21/2005)	81,233,000,000
<b>Equity</b>	47,379,000,000
<b>Debt</b>	33,854,000,000

<b>No. Shares Outstanding</b>	76,400
<b>Price Per Share</b> (as of 6/29/2005)	884,000
<b>Market Capitalization</b>	67,537,600,000

<b>P/NAV</b>	1.425
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<sup>34</sup> <http://www.ares.or.jp>

# Global One Real Estate Investment (GO)



## Nomura Real Estate Office Fund, Inc.

<b>Name</b>	<b>Nomura Real Estate Office Fund, Inc.</b>
<b>Ticker</b>	8959
<b>Detail</b>	Office Building Mangement
<b>Address</b>	8-5-1 Nishi Shinjuku, Shinjuku-ku
<b>Operating Company</b>	Nomura Real Estate Asset Management Co., Ltd.
<b>Listed Date</b>	December 4, 2003
<b>Primary Shareholders of Operating Company</b>	Nomura Real Estate Development Co., Ltd. (100%)
<b>No. of Properties</b> (as of 5/1/2005)	18
<b>No. of Tenants</b> (as of 5/1/2005)	277

### INVESTMENT STRATEGY

Nomura Real Estate Office Fund, Inc. invests mainly in real estate, primarily for office use, including leasehold interests in real estate and surface rights and trust beneficial interests backed by real estate. The fundamental goal of the Fund is to secure stable medium- and long-term earnings and to ensure steady portfolio growth. The primary areas for targeted investments are listed as the following; Tokyo, Kanagawa, Saitama, Chiba, Gunma, Tochigi, Ibaraki, Aichi, Shizuoka, Osaka, Kyoto, Hyogo, and Other large cities including the government-designated cities. Currently, 100% is invested in office assets, with 60% in the Tokyo 5ku and 88% in the 23ku area.

### VERTICAL INTEGRATION

The operating firm, Nomura Real Estate Asset Management Co., Ltd. is a wholly owned subsidiary to Nomura Real Estate Development Co., Ltd., which performs all relative operations activities. The Executive Director is a 20 year veteran of Nomura.

### INVESTOR PROFILE

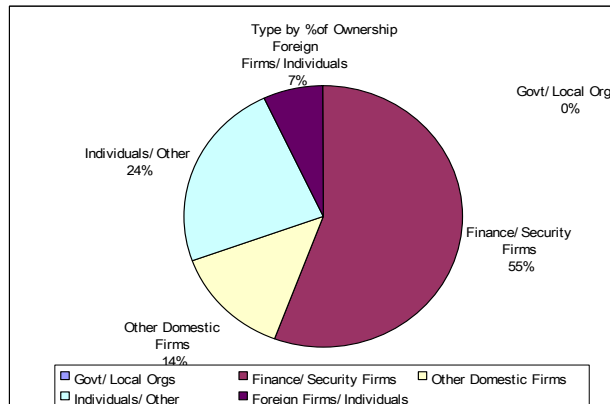
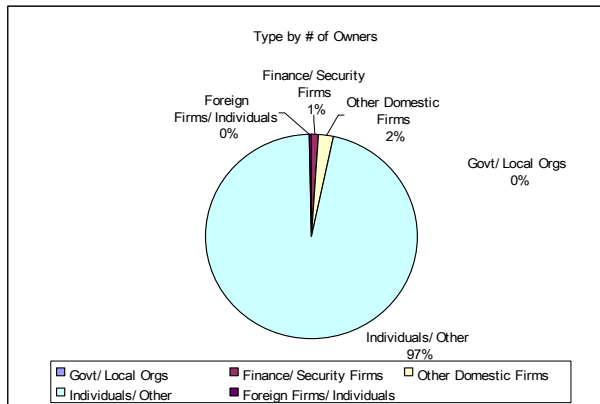
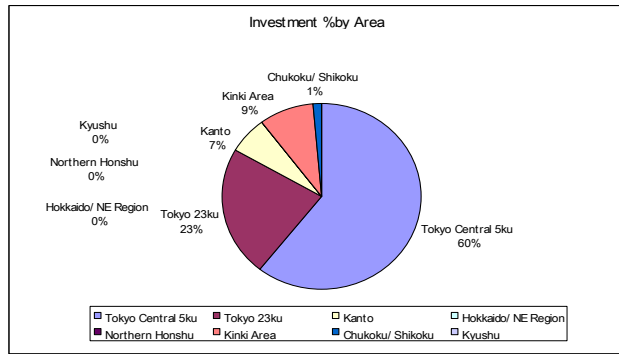
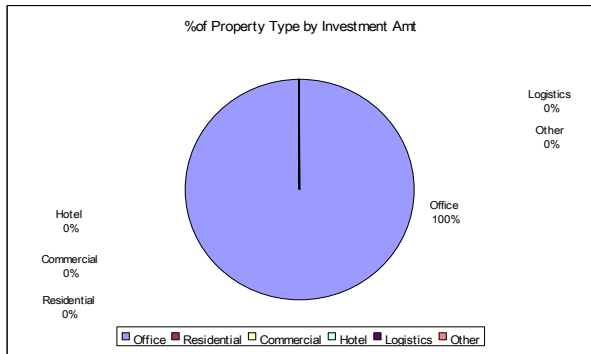
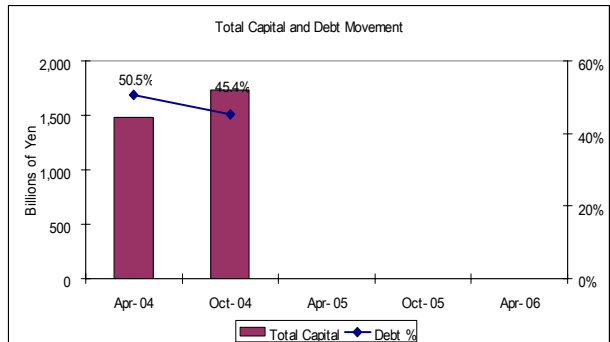
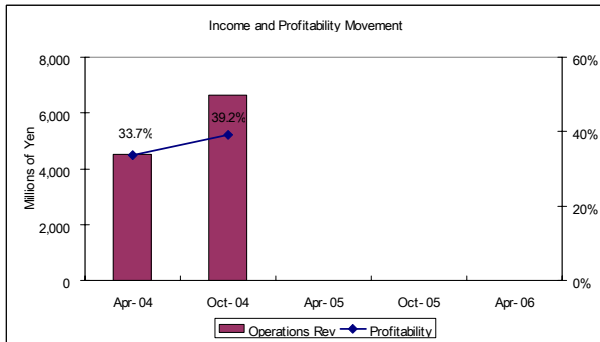
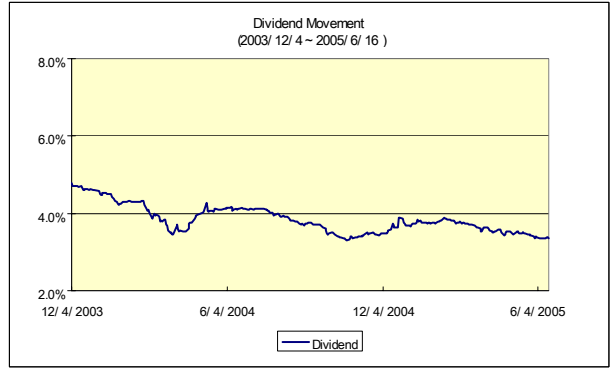
Nomura Real Estate Development Co., Ltd. holds the most share of investment units at 5.64%, followed by The bank of Ikeda, Ltd (4.72%), Japan Trustee Services Bank, Ltd. (4.43%), and Trust & Custody Services Bank, Ltd (3.05%). A total of 55% of outstanding shares are held by financial and security firms and 24% are held by individuals and 7% held by foreign firms.

### STOCK/YIELD/EARNINGS (in JPY) <sup>35</sup>

<b>Total Invested Capital</b> (as of 6/21/2005)	173,545,000,000
<b>Equity</b>	94,774,000,000
<b>Debt</b>	78,771,000,000
<b>No. Shares Outstanding</b>	229,970
<b>Price Per Share</b> (as of 6/29/2005)	838,000
<b>Market Capitalization</b>	192,714,860,000
<b>P/NAV</b>	2.033

<sup>35</sup> <http://www.ares.or.jp>

# Nomura Real Estate Office Fund, Inc.



## United Urban Investment (UR)

<b>Name</b>	<b>United Urban Investment (UR)</b>
<b>Ticker</b>	8960
<b>Detail</b>	Comprehensive (Mixed Properties)
<b>Address</b>	4-1-20 Toranomom, Minato-ku
<b>Operating Company</b>	Japan REIT Advisors Co., Ltd.
<b>Listed Date</b>	December 22, 2003
<b>Primary Shareholders of Operating Company</b>	Trinity Investment Trust LLC Marubeni Corporation Ambrose Capital Limited Tokyo Yamato Life Insurance Co. Kyokuto Securities Co., Ltd.
<b>No. of Properties</b> (as of 5/1/2005)	18
<b>No. of Tenants</b> (as of 5/1/2005)	68

### INVESTMENT STRATEGY

United Urban Investment Corp., headquartered in Tokyo, Japan, is an investment company. The Company invests in real estate properties in Tokyo and other main cities in Japan. The Company's portfolio of real estate properties includes entertainment facilities, office buildings, hotels and apartments. United Urban Investment also invests in rights of real estate property leasing, superficies and other real estate-related financial products, such as commercial paper, government and local bonds, options and others. They REIT holds 18 assets with 68 tenants distributed across the country; 40% in Tokyo central 5ku and another 31% in the Tokyo 23ku area. The remaining 29% is distributed relatively evenly among the Kyushu, Kinki and Northern Honshu areas.

### VERTICAL INTEGRATION

The operating firm is owned among Trinity Investment Trust LLC, Marubeni Corporation, Ambrose Capital Limited Tokyo, and Yamato Life Insurance Co.

### INVESTOR PROFILE

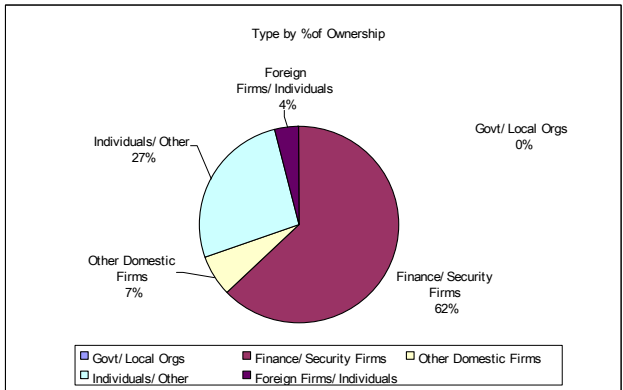
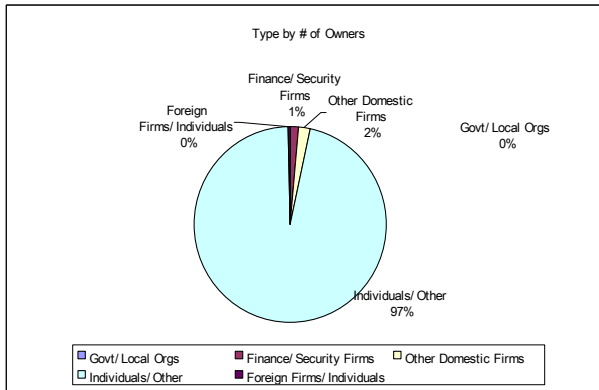
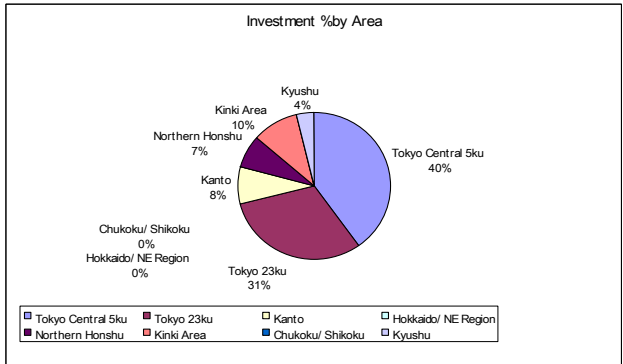
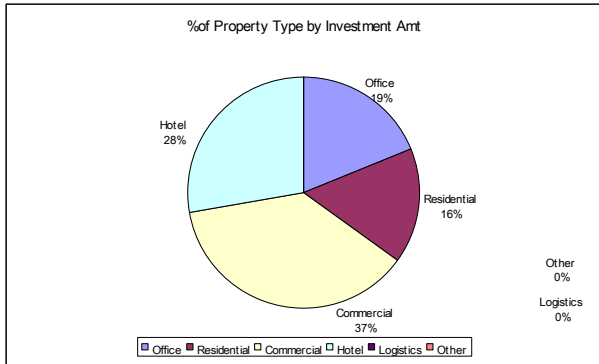
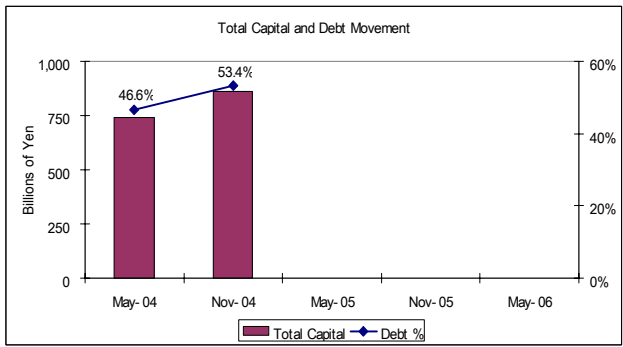
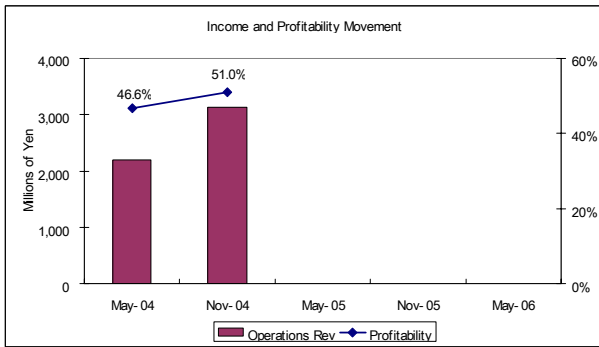
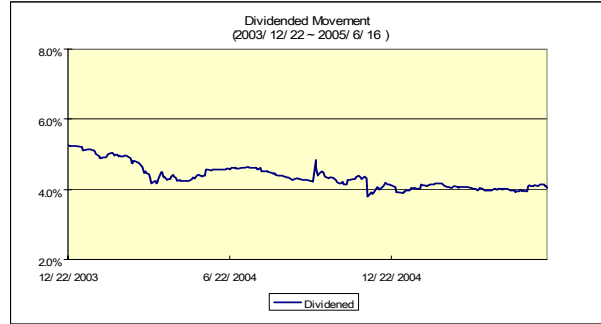
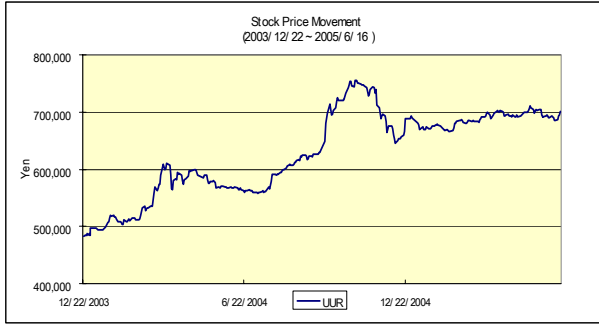
69% of issued shares are owned by domestic firms and financial institutions. 27% is held by individuals and 4% by foreign investors. Significant holders include Ikeda Bank Corporation (6.5%), Japan Trustee Service Bank (4.9%), and Japan Master Trust Bank (3.2%).

### STOCK/YIELD/EARNINGS (in JPY) <sup>36</sup>

<b>Total Invested Capital</b> (as of 6/21/2005)	86,260,000,000
<b>Equity</b>	40,194,000,000
<b>Debt</b>	46,066,000,000
<b>No. Shares Outstanding</b>	159,843
<b>Price Per Share</b> (as of 6/29/2005)	709,000
<b>Market Capitalization</b>	113,328,687,000
<b>P/NAV</b>	2.819

<sup>36</sup> <http://www.ares.or.jp>

# United Urban Investment (UUR)



## Mori Trust Sogo REIT, Inc. (Mori Trust)

<b>Name</b>	<b>MORI TRUST Sogo REIT, Inc. (Mori Trust)</b>
<b>Ticker</b>	8961
<b>Detail</b>	Comprehensive (Mixed Properties)
<b>Address</b>	1-25-5 Toranomom, Minato-ku
<b>Operating Company</b>	Mori Trust Asset Management Co. Ltd.
<b>Listed Date</b>	February 13, 2004
<b>Primary Shareholders of Operating Company</b>	MORI Trust Co., Ltd. (65%) Parco Co., Ltd. (10%) Sompo Japan (10%) Remaining 15% are split among: Sumitomo-Mitsui Banking Corporation UFJ Bank Mizuho Corporate Bank
<b>No. of Properties</b> (as of 5/1/2005)	10
<b>No. of Tenants</b> (as of 5/1/2005)	26

### INVESTMENT STRATEGY

MORI TRUST Sogo Reit, Inc. (MTR) is an investment corporation established primarily for the purpose of investing funds in and managing real estate. MTR's primary investment focus is office buildings, but MTR also makes investments in retail facilities, residential and hotel properties. The main investment target area is the six central business districts of Tokyo, followed by others such as the greater Tokyo area and major regional cities. Currently, 57% of the assets are in Tokyo 5ku and the remaining in the southern Kanto and Kinki regions at 27% and 10%, respectively. 77% of assets are in office, 18% in commercial, and the remaining in residential or other property types.

### VERTICAL INTEGRATION

Mori Trust Asset Management Co., Ltd. is primarily owned by MORI Trust Co., Ltd (65%) and five other investors, as listed above. The firm is operated by members of Mori trust and control and operates the acquisitions and asset management responsibilities of the REIT.

### INVESTOR PROFILE

44% of the outstanding shares are held by domestic financial and security firms, followed by another large percentage (36%) by other domestic firms in Japan. Only 20% are held by individual and international investors.

### STOCK/YIELD/EARNINGS (in JPY)<sup>37</sup>

<b>Total Invested Capital</b> (as of 6/21/2005)	139,526,000,000
<b>Equity</b>	82,798,000,000
<b>Debt</b>	56,728,000,000

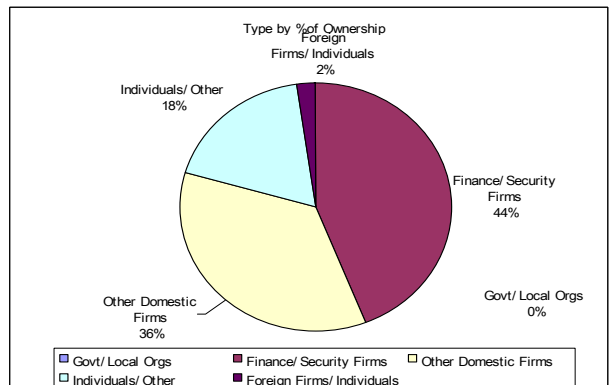
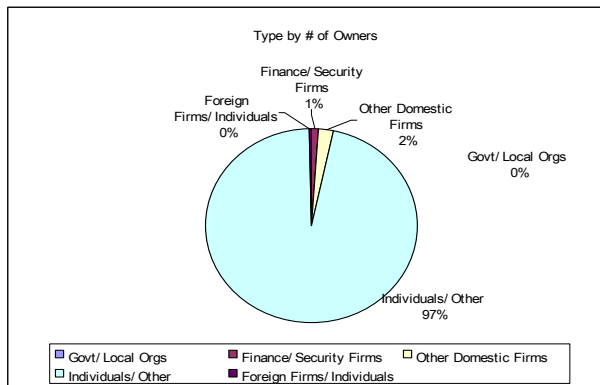
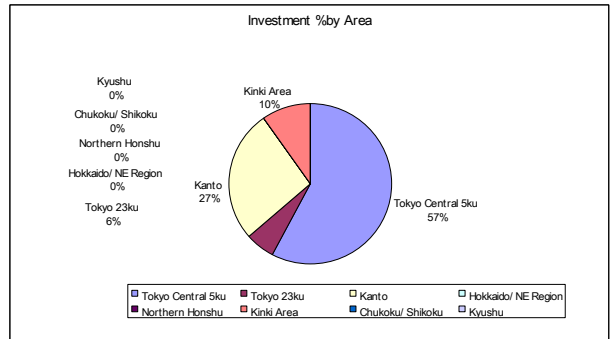
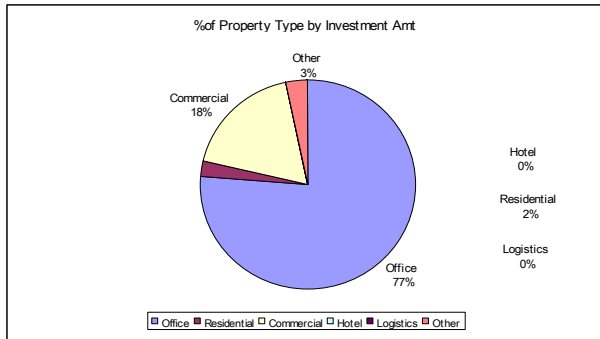
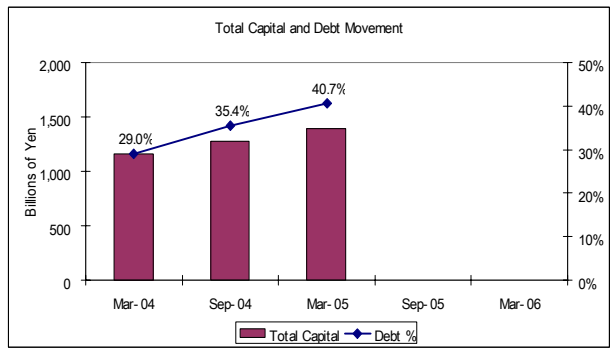
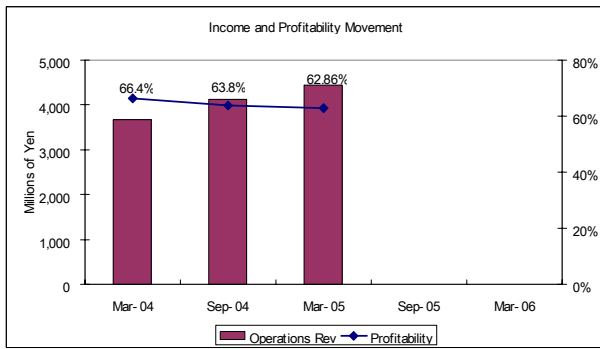
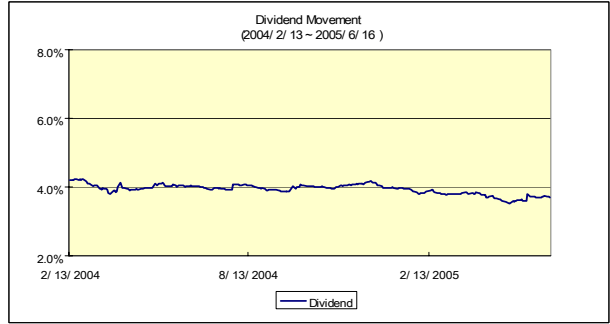
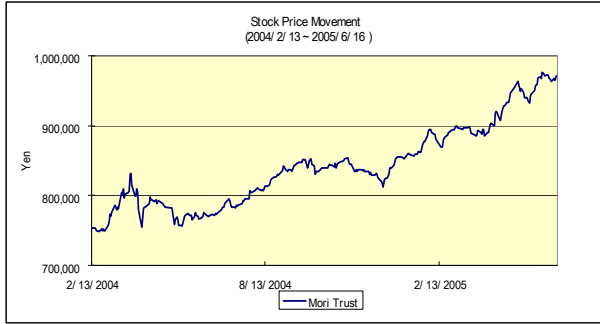
<b>No. Shares Outstanding</b>	160,000
<b>Price Per Share</b> (as of 6/29/2005)	1,020,000
<b>Market Capitalization</b>	163,200,000,000

<b>P/NAV</b>	1.971
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<sup>37</sup> <http://www.ares.or.jp>



# Mori Trust Sogo REIT, Inc. (Mori Trust)



## Nippon Residential Investment Corp. (NichiResidence)

<b>Name</b>	<b>Nippon Residential Investment Corp. (Nichi Residence)</b>
<b>Ticker</b>	8962
<b>Detail</b>	Focused on Residential
<b>Address</b>	2-11-1 Nagatacho, Chiyoda-ku
<b>Operating Company</b>	Pacific Investment Advisors Corporation
<b>Listed Date</b>	March 2, 2004
<b>Primary Shareholders of Operating Company</b>	Pacific Management Corporation (78.2%) Dai-Ichi Life Insurance (4.7%) Morgan Stanley Properties Japan (4.7%) Remaining 12.4% are split among: Bank of Tokyo Mitsubishi Mitsubishi Trust Bank Sumitomo Corporation Odakyu Real Estate Co., Ltd.
<b>No. of Properties</b> (as of 5/1/2005)	43
<b>No. of Tenants</b> (as of 5/1/2005)	43

### INVESTMENT STRATEGY

Nippon Residential Investment Corp., headquartered in Tokyo, Japan, is an investment company. The Company mainly invests in real estate properties, rights of real estate leasing, superficies and others. Nippon Residential Investment's real estate properties include various types of apartments in the Kanto area, covering Tokyo 23 districts, Saitama, Chiba and Kanagawa, Fukuoka, Kyoto and Aichi. The fund currently owns 43 residential properties, with 80% of those assets in Tokyo's 5ku and 23ku, at 40% each.

### VERTICAL INTEGRATION

The operating firm is mostly owned and controlled by Pacific Management Corporation, with 3<sup>rd</sup> party institutional investors such as Dai-Ichi Life Insurance and foreign investors like Morgan Stanley Properties Japan.

### INVESTOR PROFILE

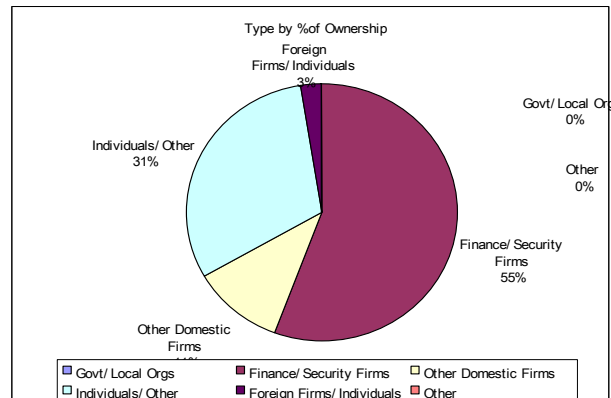
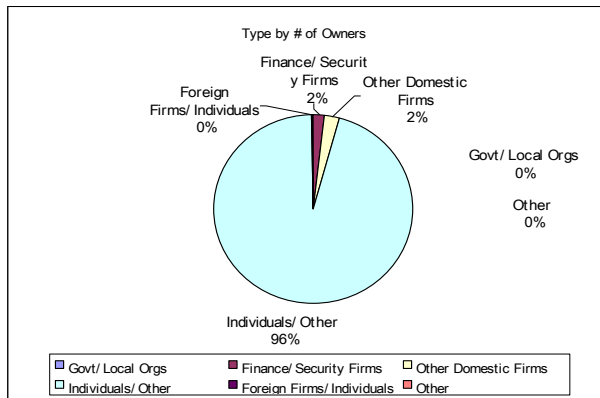
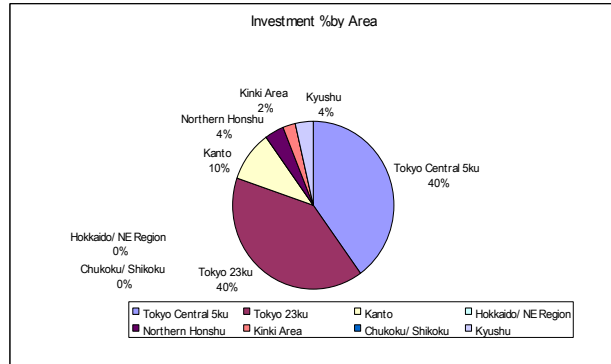
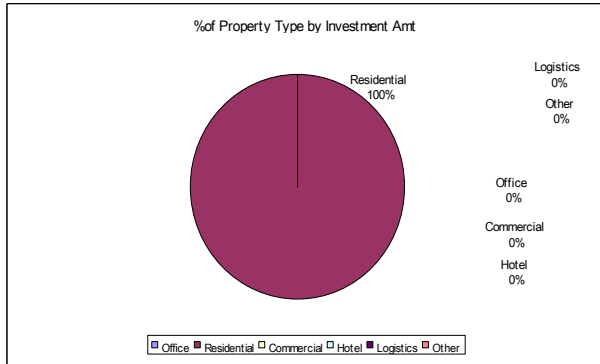
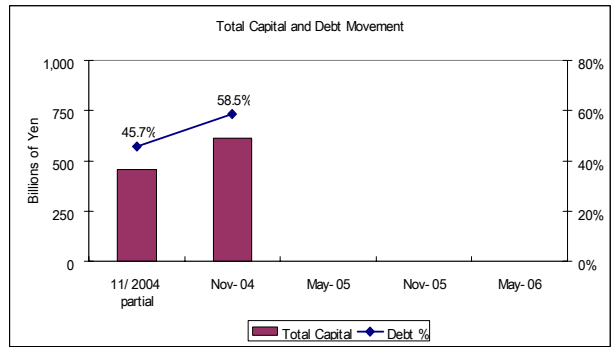
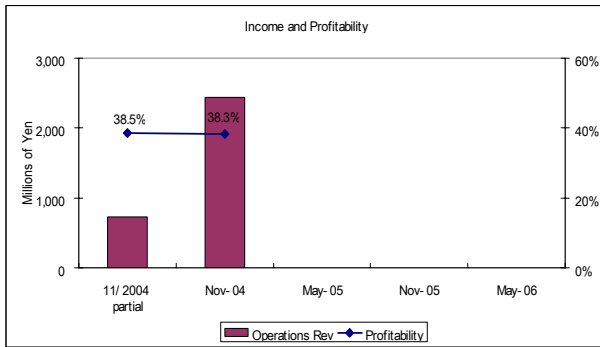
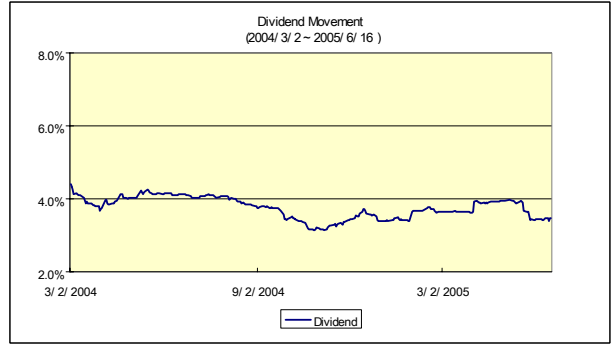
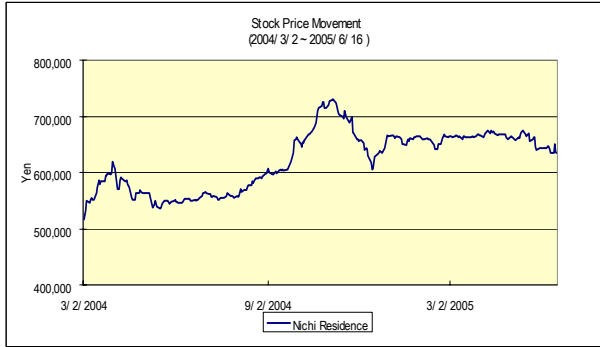
Domestic financial and security firms hold 55% of outstanding shares followed by individuals (31%) and other domestic firms (11%). Individuals and foreign investors hold the remaining 34% of outstanding shares.

### STOCK/YIELD/EARNINGS (in JPY)<sup>38</sup>

<b>Total Invested Capital</b> (as of 6/21/2005)	61,087,000,000
<b>Equity</b>	25,356,000,000
<b>Debt</b>	35,731,000,000
<b>No. Shares Outstanding</b>	142,845
<b>Price Per Share</b> (as of 6/29/2005)	641,000
<b>Market Capitalization</b>	91,563,645,000
<b>P/NAV</b>	3.611

<sup>38</sup> <http://www.ares.or.jp>

# Nippon Residential Investment Corp. (NichiResidence)



## TGR Investment, Inc. (TGR)

<b>Name</b>	<b>TGR Investment, Inc. (TGR)</b>
<b>Ticker</b>	8963
<b>Detail</b>	Focused on Tokyo Metropolitan Area
<b>Address</b>	6-8-1 Nishi Shinjuku, Shinjuku-ku
<b>Operating Company</b>	Power Investment Co., Ltd.
<b>Listed Date</b>	May 17, 2004
<b>Primary Shareholders of Operating Company</b>	Tokyo REIT Co., Ltd. HS Securities Co., Ltd. Power Management Co., Ltd.
<b>No. of Properties</b> (as of 5/1/2005)	20
<b>No. of Tenants</b> (as of 5/1/2005)	20

### INVESTMENT STRATEGY

TGR is a mixed product JREIT that focus investments on residential and office assets in the Tokyo 5ku and 23ku area. Currently 20 assets are under management with 64% residential and 36% office product. 28% of the investments are in Tokyo's central 5ku area with another 61% in the 23ku. The Remaining 11% is in Kanto area outside of Tokyo.

### VERTICAL INTEGRATION

The operator, Power Investment Co., Ltd. was founded in January 14, 2003. The primary shareholders include Tokyo REIT Co., Ltd., HS Securities Co., Ltd., and Power Management Co., Ltd.

### INVESTOR PROFILE

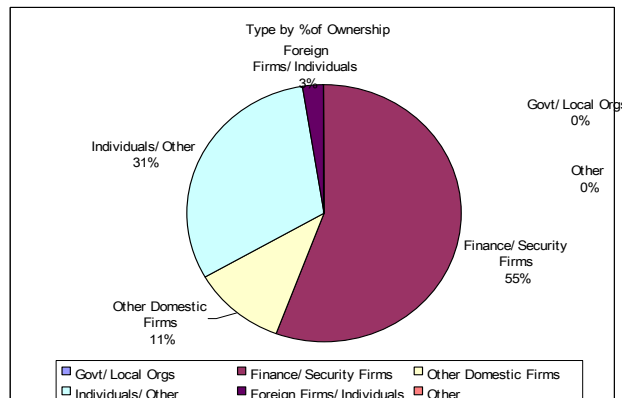
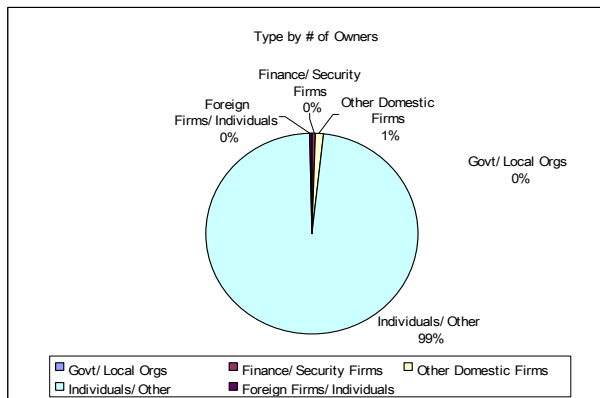
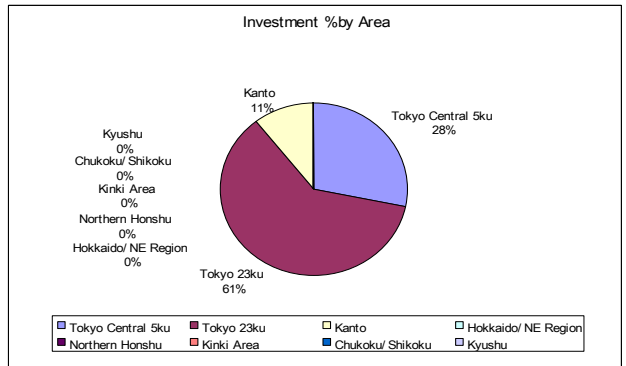
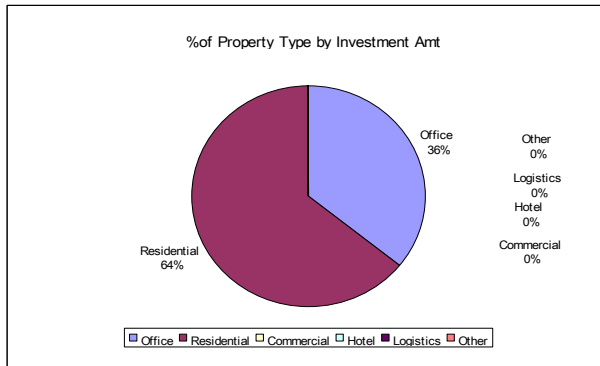
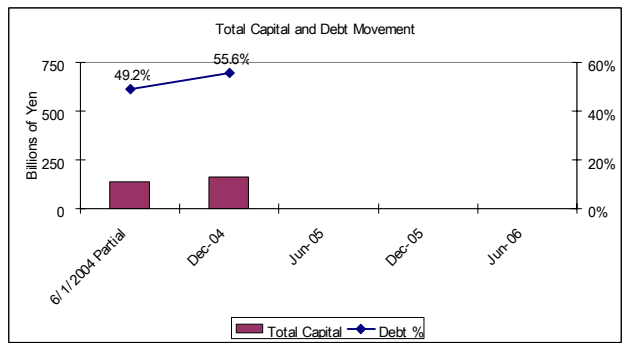
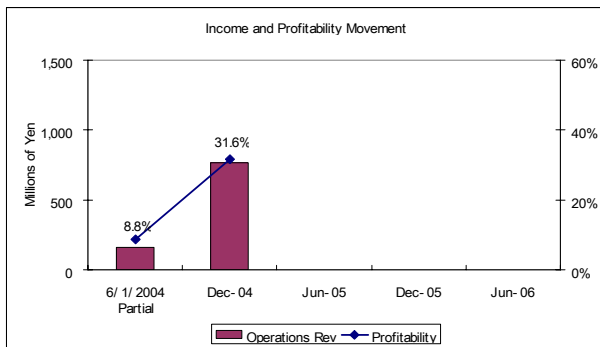
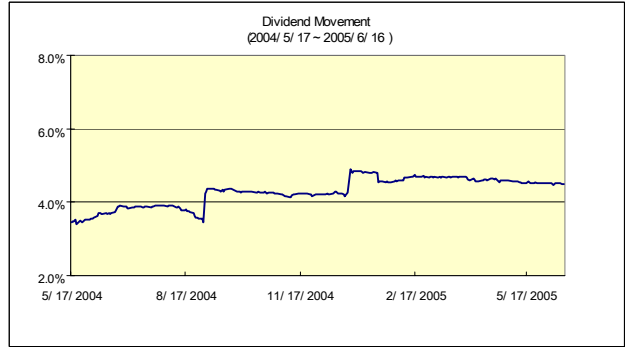
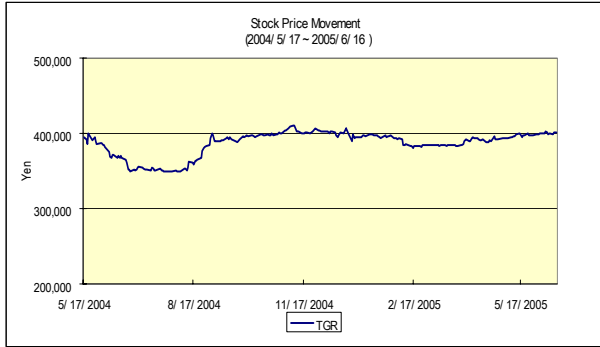
66% of the issued shares are held by domestic firms and financial and security institutions. Individuals and foreign firms hold 31% and 3%, respectfully. Some of the primary investment firms include Zenkokuhoshou Co., Ltd. with 29%.

### STOCK/YIELD/EARNINGS (in JPY) <sup>39</sup>

<b>Total Invested Capital</b> (as of 6/21/2005)	15,938,000,000
<b>Equity</b>	7,082,000,000
<b>Debt</b>	8,856,000,000
<b>No. Shares Outstanding</b>	28,898
<b>Price Per Share</b> (as of 6/29/2005)	399,000
<b>Market Capitalization</b>	11,530,302,000
<b>P/NAV</b>	1.628

<sup>39</sup> <http://www.ares.or.jp>

# TGR Investment, Inc. (TGR)



## Frontier Real Estate Investment (FRI)

<b>Name</b>	<b>Frontier Real Estate Investment (FRI)</b>
<b>Ticker</b>	8964
<b>Detail</b>	Commercial Facility Management
<b>Address</b>	2-17-22 Akasaka, Minato-ku
<b>Operating Company</b>	Frontier REIT Management Inc.
<b>Listed Date</b>	August 9, 2004
<b>Primary Shareholders of Operating Company</b>	Japan Tobacco Inc.
<b>No. of Properties</b> (as of 5/1/2005)	6
<b>No. of Tenants</b> (as of 5/1/2005)	8

### INVESTMENT STRATEGY

FRI is headquartered in Tokyo, and is an investment company. The Company mainly invests in mid to long term stabilized income producing commercial real estate properties, rights of real estate leasing, superficies and others across the nation. It currently holds six commercial assets which are diversified across the Tokyo (34%), Kanto (14%), Kinki (28%), Chukoku (17%), and Kyushu (7%) areas.

### VERTICAL INTEGRATION

The operating firm Frontier REIT Management Inc. which controls all the management and acquisitions activities of the real estate is wholly owned by Japan Tobacco Inc. Frontier has a formal strategic agreement with Japan Tobacco to develop and supply a pipeline of new investment opportunities in the future.

### INVESTOR PROFILE

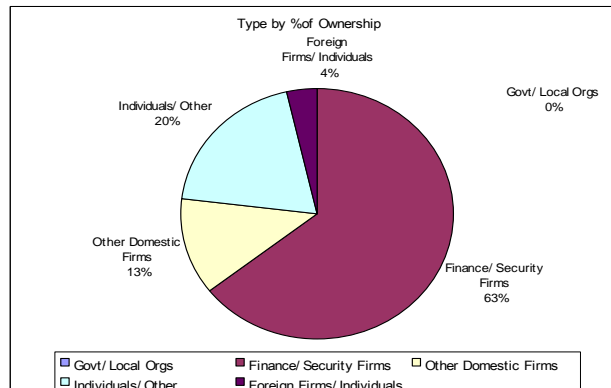
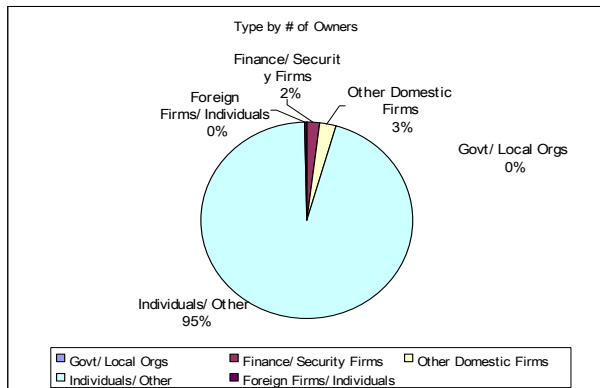
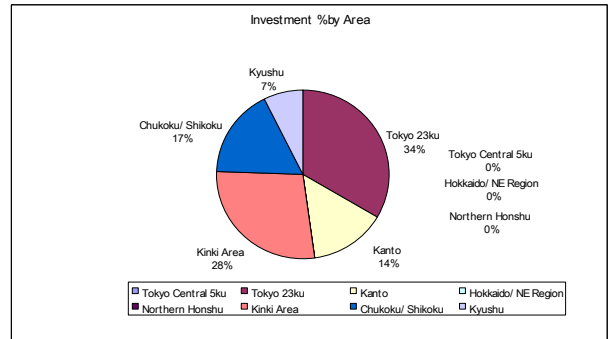
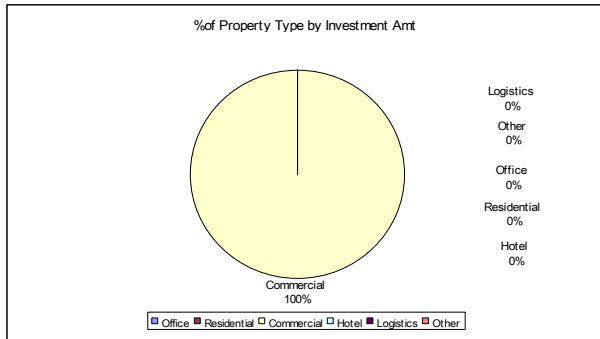
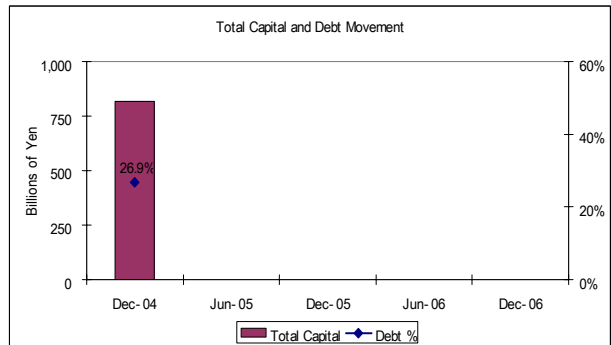
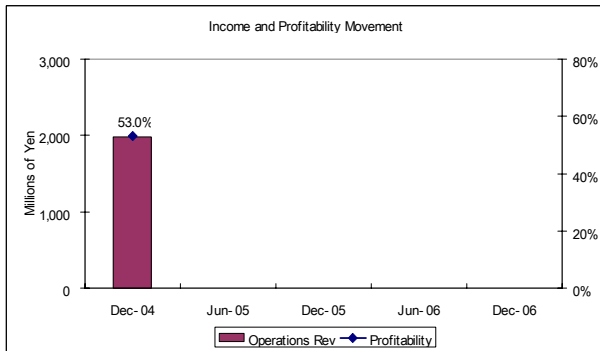
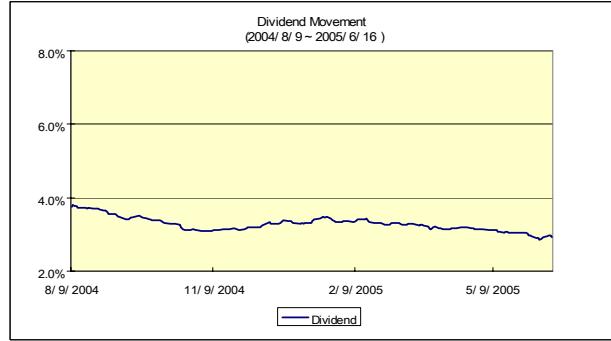
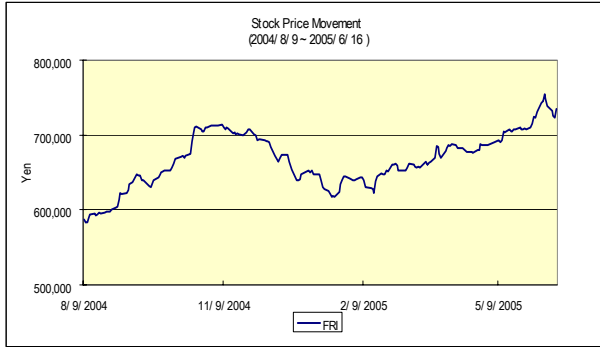
76% of the shareholders are financial institutions and domestic firms. 20% is held by individuals and 4% by foreign firms.

### STOCK/YIELD/EARNINGS (in JPY) <sup>40</sup>

<b>Total Invested Capital</b> (as of 6/21/2005)	81,547,000,000
<b>Equity</b>	59,636,000,000
<b>Debt</b>	21,911,000,000
<b>No. Shares Outstanding</b>	110,400
<b>Price Per Share</b> (as of 6/29/2005)	729,000
<b>Market Capitalization</b>	80,481,600,000
<b>P/NAV</b>	1.349

<sup>40</sup> <http://www.ares.or.jp>

# Frontier Real Estate Investment (FRI)

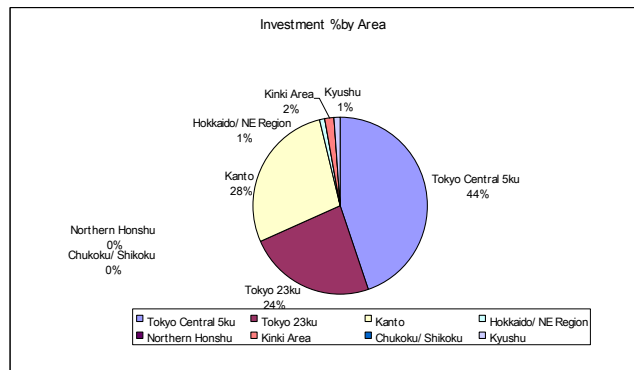
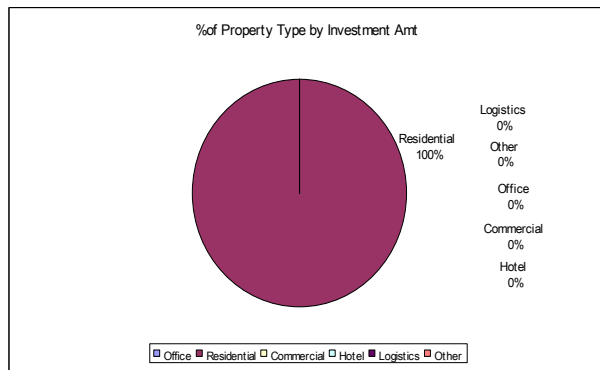
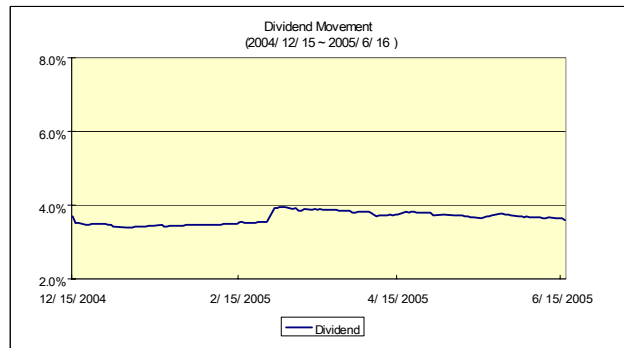
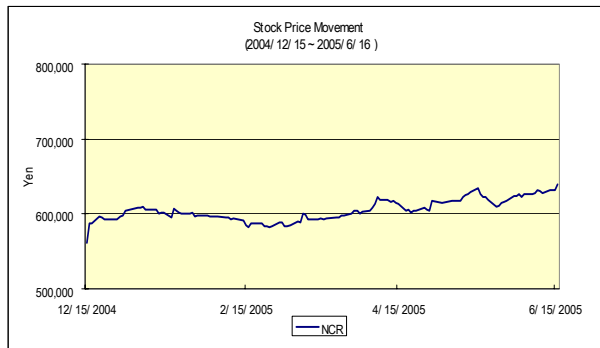


The relative newness of the following JREITs has resulted in limited access to information. As a result the summaries have been reduced.

**New City Residence Investment Corp. (NCR)**

<b>Name</b>	<b>New City Residence Investment Corp. (NCR)</b>
<b>Ticker</b>	8965
<b>Detail</b>	Residential Specialist Management
<b>Address</b>	1-10-6 Roppongi, Minato-ku
<b>Operating Company</b>	CBRE Residential Management
<b>Listed Date</b>	12/15/2004
<b>Primary Shareholders of Management Co.</b>	CB Richard Ellis Investors (42.5%) NCC Holdings LLC (42.5%) CSK KK (10%)
<b>No. of Properties</b> (as of 5/1/2005)	50
<b>No. of Tenants</b> (as of 5/1/2005)	5 (subleased) – 2,067 units

New City Residence Investment Corp. is a residential specialist that holds 50 residential buildings, subleased to 5 operating firms and occupied by over 2,000 tenants. The assets are distributed across the nation with 68% in the Central 5ku and 23ku area, and another 28% just outside of Tokyo.

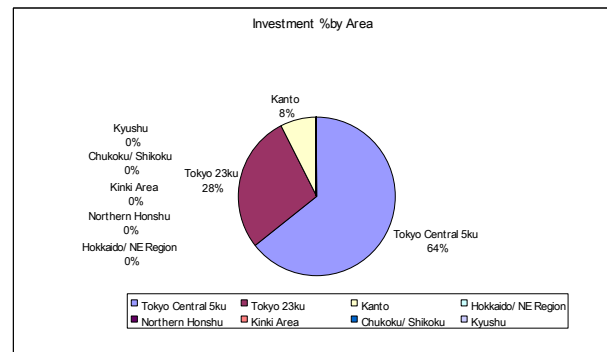
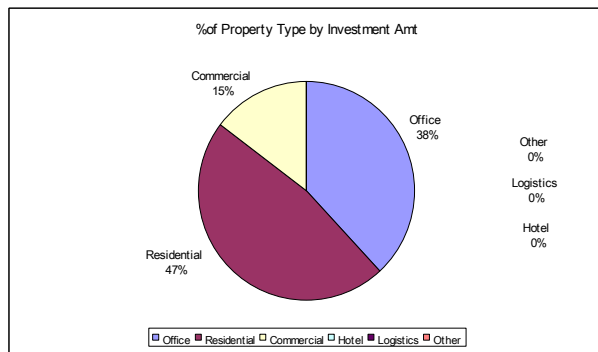
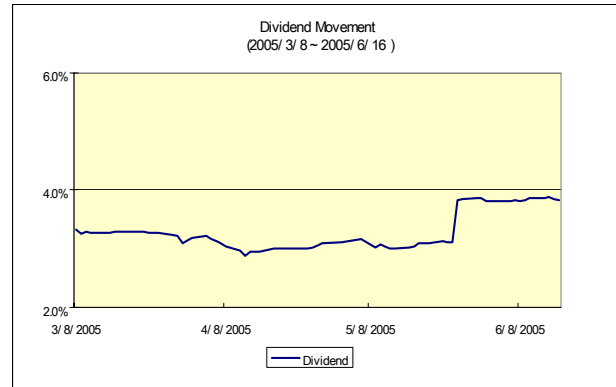
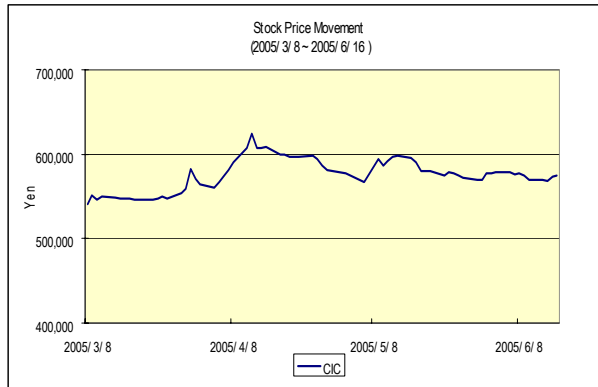




## Crescendo Investment Corp (CIC)

<b>Name</b>	<b>Crescendo Investment Corp (CIC)</b>
<b>Ticker</b>	8966
<b>Detail</b>	Mixed Office/Residential
<b>Address</b>	2-5-1 Minato-ku
<b>Operating Company</b>	Kanaru Investments
<b>Listed Date</b>	3/8/2005
<b>Primary Shareholders of Operating Company</b>	Kanaru KK. Heiwa Real Estate KK Akiyama holdings & Finance Invoice KK Itoh Finance
<b>No. of Properties</b> (as of 5/1/2005)	21
<b>No. of Tenants</b> (as of 5/1/2005)	43

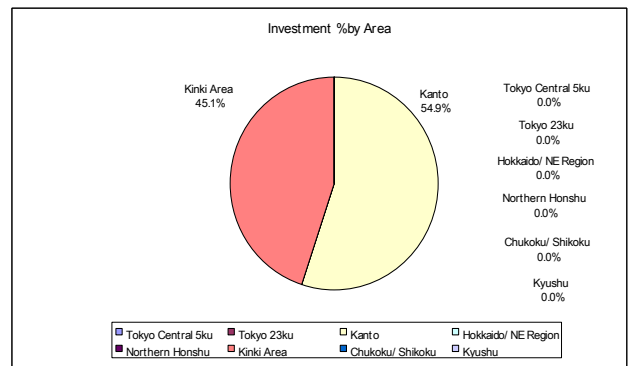
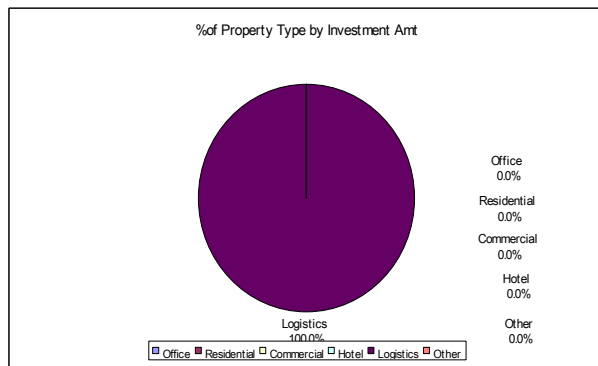
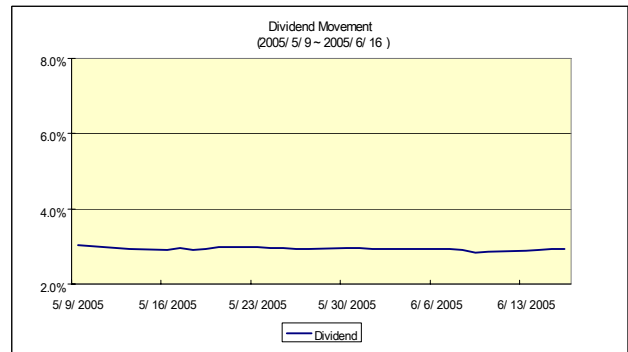
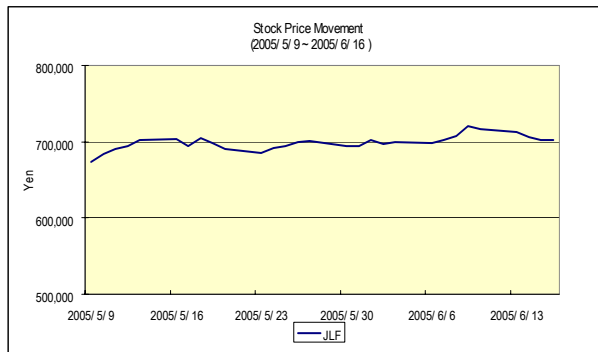
CIC is headquartered in Tokyo, and is an investment company. The Company mainly invests in mid to long term stabilized income producing office (38%), Commercial (15%), and residential (47%) real estate properties, rights of real estate leasing, superficies and others across the nation. 92% of the assets are invested in Tokyo's 23ku and 5ku area. Crescendo Investment Corp's primary investors include Daiwa Life Insurance and Fuji Fire Insurance with 14.57% each.



## Japan Logistics Fund Inc (JLF)

<b>Name</b>	<b>Japan Logistics Fund Inc (JLF)</b>
<b>Ticker</b>	8967
<b>Detail</b>	Distribution & Logistics Specialists
<b>Address</b>	3-5-1 Kanda, Chiyoda-ku
<b>Operating Company</b>	Mitsui Busan Logistics Partners
<b>Listed Date</b>	5/9/2005
<b>Primary Shareholders of Operating Company</b>	Mitsui Busan KK Chuo Mitsui Trust Bank Sanshin Lease
<b>No. of Properties</b> (as of 5/1/2005)	6
<b>No. of Tenants</b> (as of 5/1/2005)	10

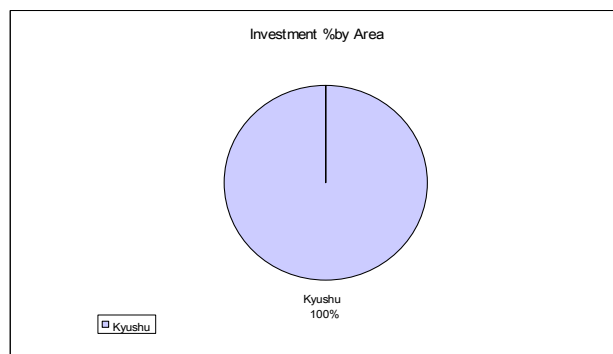
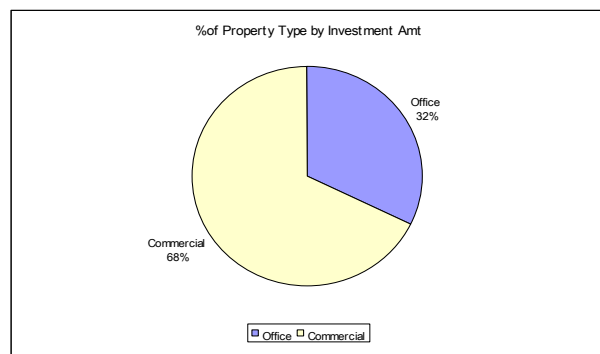
JLF is headquartered in Tokyo, and is an investment company. The Company invests solely in mid to long term stabilized income producing logistics real estate properties, rights of real estate leasing, superficies and others across the nation. 54.9% and 45.1% of the assets are in the Kanto and Kinki areas with 0% of the assets are invested in Tokyo's 23ku and 5ku area. JLF is the first fully distribution and logistics asset specialist in the JREIT market. Currently it owns and manages six assets. The operator Mitsui Busan Logistics Partners is primarily owned by Mitsui Busan and Chuo Mitsui Trust Bank.



## Fukuoka REIT Corporation (FRC)

<b>Name</b>	<b>Fukuoka REIT Corporation (FRC)</b>
<b>Ticker</b>	8968
<b>Detail</b>	Fukuoka/Kyushu Area Mixed Properties
<b>Address</b>	1-2-25 Sumiyoshi, Hakata-ku
<b>Operating Company</b>	Fukuoka Realty
<b>Listed Date</b>	6/21/2005
<b>Primary Shareholders of Operating Company</b>	Fukuoka Land FJ Land Developers Kyushu Electric Royal
<b>No. of Properties</b> (as of 5/1/2005)	5
<b>No. of Tenants</b> (as of 5/1/2005)	163

JLF is headquartered in Fukuoka (southern Japan), and is an investment company. The Company invests solely in mid to long term stabilized income producing mixed use office and commercial real estate properties, rights of real estate leasing, superficies and others across the nation. 100% of the assets are in the Kyushu area. JLF is the first to focus on the Kyushu area. Currently it owns and manages five assets with 163 assets. The operator Fukuoka Realty is primarily owned by Fukuoka Land and FJ Land Developers, which are well known institutions in the Kyushu area.



## Expected New JREITs

In July 2005 another four JREITs are targeted for IPO, which will increase the total number on the market to 21 REITs.

ID	Name	Date
8969	Prospect Residential	Scheduled 7/12 IPO
8970	Japan Single Residence	Scheduled 7/13 IPO
8972	Kinetics Real Estate	Scheduled 7/21 IPO
8973	Joint REIT	Scheduled 7/28 IPO

The following Market Facts were included to provide the reader with some basic truths about the Japanese real estate market. The bullets will provide a good indication to the characteristics of the market and some basic facts that a professional must be aware of if considering investing in Japanese real estate.

#### **REAL ESTATE MARKET FACTS - OPERATING COSTS<sup>41</sup>**

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**Rents** - The lease rents will typically be stated in JPY per month and are based on the agreed unit rent and the rentable area provided by the landlord. Usually the JPY per sqm rent is also stated in the lease. The rent is charged monthly in advance and payment is usually due on the 25th day of each month. Rent-free periods can be expected although the length of the rent-free period will depend on market conditions, size of tenant, and length and type of lease. Usually, the rent-free will at a minimum cover the tenant's construction period but may be longer in more favorable market conditions.

**Service Charges** - Typically a 'common area management charge' or 'service charge' is charged to the tenant and quoted separately in the lease although some landlords include the service or common area management charge in the contracted rent. The charge typically includes the cost of providing standard or core time HVAC for both the common and tenant areas, the cost of utilities and cleaning for the common areas, as well as building maintenance and security. The common area charge is usually fixed and non-negotiable.

**Utilities** - The landlord typically charges the tenant for the cost of water, electricity, gas and telecommunication services consumed by the tenant. Some buildings provide additional air conditioning through a local District Heating and Cooling (DHC) network, which is normally at an additional charge to the tenant.

**Insurance** - The tenant is typically not obliged by the lease to provide insurance coverage although the tenant will want to ensure that they have adequate coverage for contents and third party liability. The landlord will usually insure the building although again, there is typically no lease obligation for them to do so.

**Tax** - There are no property taxes levied directly on tenants in Japan. However, the cost of most goods and services including rent, service charges and utilities are subject to a 5% Consumption Tax. The sale or lease of land is not subject to the Consumption Tax. A Fixed Asset Tax and a City Planning Tax are levied by the local municipality on 1st January each year, on owners of land and/or buildings. The Fixed Asset Tax of 1.4% and the City Planning Tax of 0.3% are applied to the tax value of the fixed asset. These taxes are typically paid by the landlord and covered by the rent, and are not charged to the tenant.

#### **REAL ESTATE MARKET FACTS - LEASING PROPERTY<sup>42</sup>**

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**Lease Term** - A standard Japanese lease typically is for a term of two years. Longer terms of up to 20 years are available for large occupiers, although they are not typical. The standard Japanese lease provides the tenant with a high degree of security and lease flexibility with effectively an automatic right to renew and a right to terminate the lease at any time on serving notice. Whilst the lease contains provisions for the landlord to terminate a standard lease, in practice it is very difficult for them to do so. The Fixed Term Lease Law was introduced on 1 March 2000 and is intended to align Japanese Lease law with international practices to provide a more favorable investment environment. The law allows for

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<sup>41</sup> Jones Lang LaSalle. "Corporate Occupiers Guide (Asia Pacific)." JLL. August, 2004.

<sup>42</sup> Jones Lang LaSalle. "Corporate Occupiers Guide (Asia Pacific)." JLL. August, 2004.

Fixed Term Leases of any length at a fixed rent. There is no right to renew. Rent reviews are not typically included in a Fixed Term Lease but are possible by negotiation.

**Lease Renewal/ Rent Reviews** - Unless the tenant terminates a standard Japanese lease, the lease will automatically renew at the end of the term for like terms. Should the landlord wish to change the lease rent, they will forward a proposal to revise the rent typically three months prior to the end of the term. The tenant is also normally able to request revisions to the lease rent. Both parties are expected to negotiate in good faith although there is typically no formal lease mechanism for negotiating terms. If terms are not agreed prior to lease expiry, then typically the tenant will continue to pay the existing rent until agreement is reached and an adjustment payment is made. Disputes are rare and lease renewal is normally resolved without resorting to litigation. A standard Japanese lease may also include a clause that permits one or both of the parties to vary the rent during the lease term should market conditions change significantly.

**Repairs and Improvements** - Improvements to the contracted/leased area are at the tenant's own cost; there are typically no landlord contributions. The tenant will be required to use the landlord's designated contractors for some or all of the interior works although they are free to select designers, project managers and specialist consultants. Whilst the scope for negotiation on the contract is still limited, the ability to receive competitive tenders is increasing as is the scope for use of tenant contractors for some nonstructural works. The landlord is responsible for necessary repairs made to maintain the building and its fixtures and facilities.

**Subletting and Assignment** - Subletting and assignment are typically prohibited in standard Japanese lease contracts. Sharing with associated companies is usually permitted where a tenant can demonstrate a controlling interest. Expansion rights are still unusual but may be available to larger tenants.

**Early Termination** - A tenant can usually terminate a standard Japanese lease contract without penalty at any time during their tenancy, provided the tenant notifies the landlord of their intention to terminate in a written statement six months in advance. If the tenant pays six months' rental and service charges in advance, the tenant can cancel the contract immediately. Typically if the tenant terminates during the first two years of the lease, they can expect to repay the amount of any rent-free period granted as a penalty. Typically there is no right to terminate a Fixed Term Lease during the lease term.

**Security of Tenure** - The tenant's right to renew is, for practical purposes, guaranteed and it is difficult for a landlord to decline a lease renewal without good cause. In the absence of a formal notice from the landlord or tenant to terminate the contract, the expiry of a lease normally leads to its automatic renewal.

**Reinstatement** - The tenant is obliged to restore their premises, usually to the original condition, at the end of the lease and at their own cost. The landlord's contractor will provide a reinstatement estimate. In some circumstances, negotiations are possible to ensure the cost estimate is reasonable.

**Hours of Operation** - Building operating or core hours vary but are typically from 8:30 am to 6:00 pm on weekdays and 8:30 am to 1:00 pm on Saturdays in Grade A premises. During these hours, HVAC is provided to the tenants' premises and the building's common areas. Non-core hours HVAC for the tenants premises are charged separately, usually on a JPY per AC zone per hour basis in Grade A buildings and either available on demand or need to be ordered in advance, depending on the age or type of the building.

Some buildings provide additional air conditioning with a local District Heating and Cooling (DHC) network, which is typically charged to the tenant.

**Legal Advice/Fees** - Although standard leases are not lengthy compared to international standards, it is recommended that the tenant hire an experienced local legal counsel to review the lease. Whilst there are recommended legal charges, these are not mandatory and legal fees typically vary.

**Security Deposit** - Large deposits of up to 12 months' rent are standard. The deposit is refundable but is non-interest bearing. Bank guarantees are not usually acceptable. The Landlord Tenant laws in Japan provide the tenant with a considerable amount of protection (security of tenure) but the typical large deposits have been required by landlords to provide additional security in the event of default by the tenant.

## **REAL ESTATE MARKET FACTS - PURCHASING PROPERTY<sup>43</sup>**

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**Land Use Law** - Land Use Law regulates speculative investments and trading. For all sales of land over the size limit determined by the local government (2,000 sq.m. in Tokyo), the parties are required to file a notification to the local government before executing the contract. The government examines whether the sales price is appropriate in the light of National Land Agency guidelines. If the transaction price is considered extraordinarily high, the local government can require a revision in the price and/or suspend the contract.

**Foreign Ownership** - There is no restriction on the ownership of land and buildings by foreign investors. Strata Title (Partial ownership of the building)

**Agency Fees** - Agency fees for purchasing real estate are regulated by the Real Estate Trade Law. If the sales price is in excess of JPY 4,000,000 the maximum fee is 3% plus JPY 60,000.

**Legal Fees** - There is no uniform standard for legal fees – they vary according to each party's requirement and the extent of legal services required.

**Stamp Duty** - Stamp tax is paid when affixing or canceling a revenue stamp on the taxable documents listed in the Stamp Tax Act. Agreements for the transfer of ownership of real property and intangible assets are taxed at progressive amounts ranging from JPY 200 to JPY 600,000.

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<sup>43</sup> Jones Lang LaSalle. "Corporate Occupiers Guide (Asia Pacific)." JLL. August, 2004.

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